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A REVIEW OF CURRENT SECURITIES ISSUES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

EXAMINATION OF CURRENT SECURITIES ISSUES, FOCUSING ON IMPROVING FINANCIAL DISCLOSURE FOR INDIVIDUAL INVESTORS

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C O N T E N T S

TUESDAY, APRIL 25, 2006

WITNESS

A REVIEW OF CURRENT SECURITIES ISSUES

TUESDAY, APRIL 25, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:08 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

Today, the Banking Committee continues its review of the regulatory landscape in the securities markets. I would like to welcome back Chairman Christopher Cox, returning to the Committee for the first time since being confirmed to lead the Securities and Exchange Commission.

Chairman Cox's appearance this morning will provide the Committee an opportunity to learn more about his ambitious investor protector agenda at the SEC. I commend the Chairman for making vigorous enforcement of securities laws his top priority. Investor confidence in the fairness and the integrity of U.S. markets simply would not exist without an aggressive and relentless pursuit of wrongdoers. Chairman Cox's initiatives to improve the quality and usefulness of information and corporate disclosure will also benefit investors and the markets.

For example, his efforts to enhance the transparency of executive compensation will allow shareholders to compare in a meaningful way the total pay packages awarded to corporate management. Similarly, his technology-driven proposals promoting electronic delivery of proxy materials and the use of interactive data will empower shareholders to make better informed investment decisions.

Last month, the Committee held hearings on two important issues affecting investors and capital markets. The Committee's hearing on credit rating agencies demonstrated that Congressional reform of this self-regulated industry is long overdue. I was pleased to learn that a virtual consensus exists on the need to promote competition, address embedded and pervasive conflicts of interest, and establish regulatory oversight. I intend to continue working with Senator Sarbanes and other Members of the Committee in the coming months on a legislative solution to this longstanding problem.

The other recent Committee hearing examined the state of self-regulation in the securities markets. The most important development in SRO area is the conversion by each of the two major U.S.

markets to for-profit, shareholder-owned corporations. The New York Stock Exchange's unprecedented decision to make its regulatory apparatus a wholly owned subsidiary of the for-profit parent company, has generated substantial controversy. Almost all of the Committee's witnesses, representing a diverse group of market participants, questioned whether the fiduciary obligations to maximize shareholders' profits and the statutory obligations to oversee the exchange's customers and competitors could both be satisfied.

Along with rating agencies and SRO's, the Committee intends to review hedge funds, pension accounting, and other securities issues this year. I anticipate a wide-ranging discussion this morning on some of these matters.

Chairman Cox, again we thank you for your appearance today. We thank you for your service to the country, and we look forward to your testimony.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Chairman Shelby. This is another instance of the Committee continuing to perform its important role of overseeing the regulators and the important issues under our jurisdiction.

I join the Chairman in welcoming Chairman Cox, the 28th Chairman of the Commission, back before the Committee, I think the first time since we did the confirmation. Already he has worked to improve the disclosure of executive compensation, to streamline accounting rules, and to enhance the usefulness of data filed with the SEC through XBRL.

The *Baltimore Sun,* in an article, said, "SEC Chief seeks data to empower tiny investor," and went on to note that it also should vastly improve the analysis of firms by professionals in the field.

The Chairman has met with other regulators to address issues raised by the CFTC reauthorization, and by Regulation B, and given his skills in the Congress, working at developing consensus, we think the Chairman can be a very constructive person in the regulatory environment.

We appreciate the war on complexity. Things should be written in simple English. It is a new departure in this area. He has also enhanced the protection of vulnerable groups, particularly elderly investors. I think that is extremely important and I commend the Chairman for that initiative.

Another vulnerable population, I just want to note, is young military personnel. We have held some hearings here on that, and we have received testimony about abusive sales practices used by some to sell unsuitable financial products to young military personnel.

Furthermore, the Commission's effectiveness in these efforts can be, and is, enhanced by cooperating with State regulators. I am pleased that Chairman Cox has placed some emphasis on this. He noted in a recent speech that it is vitally important that we partner with them, and the complementary nature of our regulatory regimes makes us far stronger together.

There are a number of other items on the Commission's agenda, which I am sure we will review in the course of the question period here this morning.

I do want to commend the good work environment now prevailing at the SEC. It was recognized in September 2005 as one of five best places to work in the Federal Government, a study by the Partnership for Public Service and *U.S. News and World Report.* That effort began when Chairman Cox assumed his responsibility, and a lot of it actually came from this Committee, as we tried to get resources for the Commission, pay parity for its employees, to stem the outflow of seasoned personnel, but I know that Chairman Cox is very strongly committed to enhancing and sustaining this position, and we hear—I do not know whether to describe it as the grapevine—but we heard through lots of sources that things have gotten better at the Commission in terms of the work environment. We think it is important to continue that. I notice the Chairman is having considerable success in attracting some very able people to fill important positions, although he has still got some open positions yet to go.

Mr. Chairman, I look forward to the question period.

Chairman SHELBY. Thank you.

Senator Hagel.

STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Mr. Chairman, thank you, and I look forward to hearing from our witness, the respected Chairman of the Securities and Exchange Commission, and also appreciate his efforts in leadership over the last year.

Thank you.

Chairman SHELBY. Senator Dodd.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you, Mr. Chairman, for holding the hearing. And we thank Chairman Cox for being here with us as well. Now he had a little bout in January, and he tells me he is back on his feet and got a clean bill of health, so we welcome you to the Committee. It is good to see you. It has been a while but we are grateful for your presence here today.

I have had a chance to look over your testimony, and Senator Sarbanes and the Chairman have highlighted some of the points that you make in the testimony, which are worthwhile. Certainly, helping out those who may be most vulnerable in our society, particularly seniors and others, to understand exactly what they are getting into is worthwhile, so I commend you for that.

This is a quiet time in some ways in terms of the securities industry. We welcome that to some degree, considering what we have been through, but it is also an important time. It is during these quiet periods that not only we do not end up passing a lot of legislation, but also what the regulator does during the quiet time can really make a huge difference. I have been impressed in watching the Commission as it has grappled with some very significant issues.

I am very interested in hearing from you, Mr. Chairman, on the advisory committee's report on Sarbanes-Oxley, which is a big issue that has gotten some attention in the media recently. I am interested in hearing about the mutual fund regulations as well. I know that has also received a lot of attention. The credit rating agencies,

a very important issue to come before the Committee. So there are a lot of major issues the Commission is grappling with that will have significant implications. So while we are not passing major bills up here right now, it is a very important time, in my view, in terms of setting the table for what the investor community can anticipate.

I had a chance, privately, just a minute ago, talking to the Chairman about the speech he gave in China as well, and I am interested in hearing maybe some comments on your experience there and what is going on internationally in terms of people, foreign investors coming to the United States, and the kind of environment we create here, and whether or not we are going to sustain that environment, a very important issue as well.

So thank you for being here. I look forward to your testimony. I notice that the Dow Jones had a 6-year high yesterday, and I asked the Chairman whether or not he was going to take credit for that this morning, and he wisely said, "I do not think I will because it is apt to go down in a couple of days and I do not want you accusing me of being responsible for that either." So we will leave the Dow record here as being caused by other events.

But I wanted to underscore the point Senator Sarbanes made as well, and that is, the environment at the SEC. You are following a very good Chairman, and following him in many more ways than just succeeding him, so I commend you for the environment you are creating there and the quality of people that you have working with you.

Thank you for being here.

Chairman SHELBY. Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman.

Welcome, Chairman Cox. It is good to see you, and I am glad to see that you have recovered from the surgery that you had.

I am happy to read in your testimony that you are focusing your efforts on the individual investor, I do not think many SEC chairmen have done that, and also using plain English. As our Chairman has said, the language of the SEC is unusual to say the least. To allow individual investors to step on a level playing field is a great step in the right direction. I wish more in Washington would follow your lead.

Anything that can be done to improve access to information and people's understanding of it will help both the new and experienced investor. Your program to use modern electronic communications to reduce the burden on companies and the SEC will lead to more efficient regulation and management. But most importantly, it will give investors more and easier access to financial data, and that will help them make better investment decisions, and hopefully, encourage more Americans to get into the markets.

Welcome, Chris. I am glad to see you here. Thank you.

Chairman SHELBY. Senator Sununu.

STATEMENT OF SENATOR JOHN E. SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman.

Welcome, Chairman Cox. Last year, I believe of the 25 largest initial public offerings of stock in the world, only 4 of the public offerings were issued on U.S. exchanges. I think there are real questions as to whether, at least in part, that dramatic change in the focal point of U.S. exchanges is being that the best source of capital in the world was due to new regulation, Sarbanes-Oxley or other regulations, or changes in the regulatory environment on the U.S. exchanges. I think it would be a huge mistake if American exchanges lost their standing and their position in the world for attracting listings, for attracting capital, for attracting investors, and that really is a cornerstone of our American economy.

So, I am very interested in the work you are doing to address the concerns that have been raised with Section 404 in particular, and I certainly applaud the work that you have done on improving transparency and disclosure, improving some of the technology that is being used to share information with those individual investors Senator Bunning spoke of, and I look forward to your testimony.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman. I would also join the other Members of the Committee in welcoming Chairman Cox before our Committee. I am looking forward to your testimony.

As we all know, vibrant security markets are vital to more than 50 percent of the families throughout the country. A lot of people have a stake in the stock market. And in order for our Nation to continue to prosper, I think we need to have a lot of confidence, there has to be a sense of fairness, integrity, and efficiencies in the stock market.

I would share some concerns also with what is happening now with the exchanges and the self-regulatory principles that we have put in place, and how they are applying today. I am convinced that as the new Chairman, you will stay on top of the new technologies and everything, because I know this is something that has always been of interest to you. So, I just want to take this opportunity to welcome you to the Committee. I consider you a friend, having been a former colleague of yours in the U.S. House. I have always viewed you as somebody who is willing to step up to the plate and make changes when necessary. I would like to hear some of your thoughts, so I am looking forward to your testimony today.

Chairman SHELBY. Chairman Cox, again, welcome to the Committee. Your written testimony will be made part of the hearing record in its entirety. You proceed as you wish.

STATEMENT OF CHRISTOPHER COX
CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION

Chairman COX. Thank you very much, Mr. Chairman, Senator Sarbanes, and Members of the Committee. I want to thank you for giving me this opportunity to be here today to testify about the initiatives and the priorities of the Securities and Exchange Commission, in particular with reference to improving financial disclosure for individual investors, which several of you have referenced in your opening comments.

Several years ago, in the midst of financial scandals that rocked the country, and a crisis of investor confidence, this Committee held a series of very consequential hearings on the topics of corporate responsibility and investor protection. Those hearings laid the groundwork for landmark reforms that have restored investor confidence and the health of our capital markets. I want to commend you for your efforts, and I am happy to report that the Securities and Exchange Commission is using the tools that you gave us to ensure that those reforms are implemented in exactly the way that Congress intended.

A lot has happened in the 9 months since I was last here before you, and I appreciate this opportunity to give you a report on the new initiatives the SEC has undertaken and to hear further from you about your priorities.

The principal subject of my brief testimony is improving disclosure for the benefit of individual investors. If I may, I would like to take a step back and put these efforts into context.

As a Member of Congress for 17 years, I was constantly reminded by my constituents of the real-world impact of the decisions that we make here in the Capitol every day. Like you, I learned the importance of being a good listener, and of remembering that the common sense of ordinary Americans is the essence and the strength of our democracy.

Most of our constituents are not investment bankers, accountants, or lawyers, but most of our constituents are investors. It is a stunning fact of life in the 21st century that a majority of Americans now own stocks, either directly or in the form of mutual funds. It is chiefly to serve these people that the SEC exists. Our mission, to protect investors, promote capital formation, and maintain orderly markets, must always put ordinary Americans first.

Since making the transition from the halls of Congress to the SEC, I have set out to rededicate the Agency's ongoing efforts in virtually every area to the service of the individual investor.

In a well-ordered market, educated consumers can choose from a number of competitive products, and find what they want at a price that they are willing to pay. But, in order to educate themselves, investors need comparative facts. So while investors must bear the responsibility of learning what they can about their investment choices, the correlative duty of sellers of investment products is to provide the relevant information.

To more closely match the theory of a well-ordered market with today's reality, the SEC is currently pursuing four key initiatives to improve the quality and usefulness of disclosure for individual investors. These four initiatives are: Moving from boilerplate legalese to plain English in every document intended for retail consumption; moving from long and hard-to-read disclosure documents to easy-to-navigate webpages that let investors click through to find what they want; reducing the complexity of accounting rules and regulations; and focusing our antifraud efforts, in significant part, on scams that target older Americans.

It is the SEC's job to see to it that financial data and qualitative information about the issuers of securities are fully and fairly disclosed. But we cannot say that we have achieved that objective if

the information is provided in a way that is not clearly understandable for the men and women to whom it is directed.

Empowering investors does not just mean better access to information, it also means access to better information. Empowering investors is our number one job. And simply put, the question is: Once that SEC-mandated information is available, is it understandable? The answer all too often is a resounding and frustrated "no."

Exhibit A, when it comes to convoluted disclosure, is today's regime for reporting executive compensation. Ordinary American investors have a right to know what the company's executives are being paid, because those investors own the companies. The executives work for them.

How can an investor judge whether he or she is getting the best executive talent at the best price? Too often the most important parts of total compensation are hidden away in the footnotes or not even disclosed at all until after the fact.

Three months ago, the Commission voted unanimously to propose an overhaul of the executive compensation rules. The proposal would require better disclosure on several fronts.

First, companies would report a total figure, one number, for all annual compensation, including perquisites.

Companies would also outline retirement benefits and payments that could be made if an executive is terminated, and would fully disclose all compensation to board members for the past year. That is something that does not happen under today's rules.

In addition, a new Compensation Discussion and Analysis section would replace the Compensation Committee Report and the performance graph under today's regime, because in today's system that disclosure is all too often pro forma, boilerplate, and legalese.

Finally, since the purpose here is to improve communications for the consumer, the proposed rules require that all of this disclosure be in plain English, the new official language of the SEC.

Just to be clear, the Commission does not propose getting into the business of determining what is the proper method or level of compensation. It is not the job of the SEC to substitute our judgment for that of the board. Nor would I, speaking as Chairman, subscribe to the notion that all executive pay is excessive. Surely, many executives deserve every penny they get and more. Being a CEO requires a rarified collection of attributes and skills that are in all too short supply, and compensation in the market for executive talent can be fierce. At the same time, I need not cite here the several notoriously public cases of extravagant waste of shareholder assets by gluttonous CEO's and pliant compensation committees.

It is a testament to the importance of this issue that, when the comment period on these proposed executive compensation rules was closed, we had received 17,000 comments, one of the highest totals in the 72-year history of the Securities and Exchange Commission.

Making the SEC's mandated disclosures actually useful to investors is the idea behind another of our initiatives: Interactive data. Today, the SEC has over 800 forms. Yet it has been estimated that the SEC might instead have need for no more than a dozen.

The key to making this happen is looking at the data on the forms independently from the forms themselves. That is what we mean by interactive data. Computer codes can tag each separate piece of information on a report and tell us what it is: Operating income, interest expense, and so forth.

For individual investors, this means they will be able to quickly search for any information they want, without slogging through an 80-page disclosure document. Our initiative to let investors get information fast, easily, and all in one place envisions this added benefit: Instead of long and hard-to-read annual reports and proxy statements, investors could have easy-to-navigate webpages that let them click through to find what they want.

With today's SEC reports, an investor or analyst who is looking for comparative data on, say, annual capital expenditures of two companies has to search through hundreds of pages of the filings of each company, page-by-page. Not surprisingly, this very time-consuming task has created a cottage industry in rekeyboarding information in SEC reports so that it can be downloaded into spreadsheets and other software. Investors, or more precisely, the intermediaries, whose fees they pay, can then buy this information from both domestic U.S. firms and overseas providers to whom the drudge work has been outsourced.

One hates even to think of the human error and data corruption that inevitably occurs in this process.

Interactive data is a way to eliminate these problems, and to connect investors directly to the information in a company's filings. The SEC is strongly committed to interactive data and has taken major steps to promote it. We have offered significant incentives for companies to file their financial reports using interactive data, and companies are now beginning to do this.

These incentives include expedited review of registration statements and annual reports. A number of well-known firms—the list is now 17 and still growing—have already begun to lead the way and are filing their reports using interactive data. Starting in June of this year, the Commission will host a series of roundtables focused on how we can move to interactive data faster.

Revolutionizing the way the world exchanges financial information is a worthy goal. We intend to achieve it.

When it comes to giving investors the protection they need, information is the single most important tool that we have. It is what separates investing from roulette. But, if the SEC is truly to succeed in helping investors with more useful information, we will need one more ingredient: An all-out war on complexity.

At the SEC, we are looking at results from the vantage point of the ordinary investor, and what we are finding is that, in many cases, we are not getting the right results.

It is not just public companies that have a problem using plain English. Our accounting rules and regulations also can be complex and difficult to interpret; and, when the rules are difficult to interpret, they may not be followed very well. And, if the rules are not followed very well, then, intentionally or not, individual investors inevitably will suffer.

Weeding out the counterproductive complexity that has crept into our financial reporting will require the concerted effort of not only

the Securities and Exchange Commission, but also the FASB, the PCAOB, and every market participant. This cannot be a one-time effort. We will have to commit for the long-term. But it will be well worth it.

Finally, let me turn to our efforts to protect older Americans against financial fraud. Consider these statistics. An estimated 75 million Americans are due to turn 60 over the next 20 years. That is an average of more than 10,000 people retiring every day. Households led by people aged 40 or over are already owners of over 91 percent of America's net worth. Very soon the vast majority of our Nation's net worth will be in the hands of the newly retired.

Following the Willie Sutton principle, the scam artists will swarm like locusts over this increasingly vulnerable group because that is where the money is.

On a daily basis our Agency receives letters and phone calls from seniors and their caregivers who have been targeted by fraudsters. Often the victims have already been taken in. These fraudulent schemes may begin with a free lunch, but we want to make sure that they end with a very high cost to the perpetrators.

That is why we are attacking the problem from all angles, from investor education, to targeted examinations, to aggressive enforcement efforts. Because State securities regulators share our concerns in this area, we are cooperating in this initiative with State regulators across the country.

Each of the four initiatives I have outlined is part of an overall strategy to make the individual investor, the average American, the ultimate beneficiary of everything that we do at the SEC. Our Agency has for many years proudly worn the badge of the investor's advocate. In the months and years ahead, we are pledged to rededicate ourselves to that mission.

I appreciate the opportunity to be with you here today, Mr. Chairman and Members of the Committee. I want to thank you for your continuing strong support of the work of the Commission, and I am happy to be here to answer any questions that you have.

Chairman SHELBY. Thank you, Chairman Cox.

The Banking Committee has been actively reviewing the role of credit rating agencies in the capital markets. The rating industry is extremely powerful and is dominated by only two firms that do not actually compete with each other, as evidenced by the fact that Standard & Poor's and Moody's, each rate more than 99 percent of the debt obligations and preferred stock issues publicly traded in the United States.

In your view, Mr. Chairman, what is the impact of this extreme concentration and absence of competition with respect to ratings quality, pricing, innovation, and business practices?

Chairman COX. Mr. Chairman, as you know, this area has been one of intense focus, both for the SEC and for this Committee. It has also been a subject of legislative interest in the other body.

First, let me say I appreciate the Congress's bicameral and bipartisan attention to this issue, particularly your emphasis on increasing and encouraging competition in the market for the provision of credit ratings, given that the market, as you point out, is dominated presently by a few firms.

The principles that I think that we support at the Commission and that I know have been the focus of discussion here in the Congress, when it comes to a regulatory approach to the NRSRO's, would be, first, avoiding erecting any new barriers to entry and promoting competition in the market for the provision of credit ratings for regulatory compliance purposes. Second, utilizing an entry process that is transparent, timely, and that accommodates a variety of business models. Third, I think the focus that we have seen and the discussions in this Committee and throughout the Congress on managing conflicts of interest is very important. Conflicts of interest can arise between NRSRO's and issuers, and we have to ensure that ratings issued for regulatory compliance purposes, notwithstanding these potential and sometimes actual conflicts of interest, are independent and objective.

Finally, I think we have to prevent the misuse of material, nonpublic information by NRSRO's or their associated persons. So all of these things have to feature into any reforms that are adopted either legislatively or in a regulatory way. And as you know, we are deeply into this at the Commission, and have been for several years now.

Chairman SHELBY. Thank you. Following up on that, it is my understanding, Mr. Chairman, that the regulation of rating agencies essentially begins and ends when a rating agency receives a license from SEC staff designating it as nationally recognized statistical rating organization. That is to say, it is my understanding there is no ongoing oversight or inspections by the SEC once the NRSRO license is awarded.

Given the overwhelming evidence—and we have had a hearing here on this, as you know—relating to conflicts of interest, aggressive and anticompetitive practices, and the well-known failures to warn investors about impending bankruptcies—Enron, WorldCom, and others, including a place you are familiar with, Orange County, California—do you believe that self-regulation is working in this area of the concept?

Chairman COX. Chairman Donaldson testified to this Committee on this subject, that without additional legislative authority, the SEC will not be able to regulate in a thoroughgoing way, the NRSRO's. What we can do under present law is withdraw an NRSRO's no-action letter. We can bring an enforcement action against an NRSRO for violation of the antifraud provisions of the Federal securities laws, and at least with respect to S&P, Moody's, and Fitch, which are registered as investment advisers, we can regulate them under the Investment Advisers Act.

Chairman SHELBY. We want to work with you to give you whatever means you need, and I believe we can do it in a bipartisan way.

The New York Stock Exchange Regulation, the Committee recently held a hearing, Mr. Chairman, on the state of self-regulation in the securities industry with a particular focus on the implications of the New York Stock Exchange's unprecedented decision to keep its regulatory unit in-house even after conversion to a for-profit, shareholder-owned entity.

As your colleague, Commissioner Paul Atkins, at the SEC recently noted, revenues derived by the NYSE regulation will roll up

on a consolidated basis to the New York Stock Exchange Group, the public company. That means that penalties collected by the New York Stock Exchange Regulation will roll up into the aggregate revenue calculations of the New York Stock Exchange Group. This further compounds the inherent conflict of a for-profit entity possession regulatory authority over customers and potential competitors.

Do you have some concerns there. Some of us do, but we think the ground has changed a little out there.

Chairman COX. The ground is changing. This is a new world that we are entering upon. The evolution of our major exchanges into for-profit entities, the demutualization of the markets, and the prospect of global competition present challenges to our historical regulatory approach.

The fundamental principle that we need to keep in mind going forward is that, in order to be effective, regulation needs to be independent and arms' length. The for-profit structures that——

Chairman SHELBY. Has to be considered open too, does it not?

Chairman COX. Pardon me?

Chairman SHELBY. Fair. A regulation has to be considered to be fair too.

Chairman COX. Of course. The reality and the perception are equally important; and, of course, ultimately the perception is driven, one would expect, by the reality.

The Commission has already taken action designed to strengthen regulatory independence, but I look at this as a beginning, not an end. When we approved the NYSE merger, we requested—and the NYSE Board accommodated us in those requests—some additional changes to further strengthen the independence of regulation there. But, in my conversations with the management of the NYSE, I made it very clear—and I think it is their understanding as well—that we are at the threshold of understanding where this is all going to lead us, and we have to be very nimble in our approach. We have to be willing to constantly adjust and improve.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

I want to make a couple observations before I put a question. First of all, Senator Dodd referred to the fact that things were relatively quiet, and that the Dow Jones average reached a 6-year high on Friday. It seems to me that creates something of a tendency to forget, or to get a a sense of amnesia. Just to make sure that does not happen, I want to just note three enforcement actions that have happened in the last month or so.

On March 16, the SEC settled on enforcement action against Bear Stearns for securities fraud for facilitating unlawful late trading deceptive market timing of mutual funds by its customers, and customers of its introducing brokers. They will pay $250 million—$160 million in disgorgement, $90 million in penalty.

Tyco agreed to pay a $50 million settlement to the SEC charges that is used improper accounting, overstating its reported financial results, smoothing those reported earnings, hiding vast amounts of senior executive compensation, and a large number of related party transactions from investors.

April 20, just a few days ago, JPMorgan Chase and Company announced that it agreed to pay $425 million to settle class charges over its role in a scheme in which 55 underwriters allegedly defrauded investors of billions of dollars through hundreds of initial public offerings during the 1990's technologies bubble.

So the responsibility of the SEC is to do all that it can to prevent and preclude such practices, and sustain the reputation of our capital markets for integrity, transparency, and honesty.

Now, Ernst & Young has just done a report on Global IPO Trends, 2006. And in that report they note that the U.S. capital markets are perceived by issuers and investors as the gold standard, particularly as it relates to corporate governance. Companies realized evaluation premium in the form of a higher-price earnings, or similar multiple, as compared to what a similar company receives on another exchange. One observer has said: Motivation for most companies listing in the United States is evaluation premium averaging 30 percent that accrues as a result of adhering to high standards of governance.

Now, that report went on to note that exchanges outside the United States have significantly different regulatory and corporate governance requirements, and that some exchanges are aggressively marketing the fact that their exchange has lower regulatory requirements than in the United States.

They go on to say, "These lower regulatory requirements translate into increased risk for investors participating in those exchanges, as they often do not have similar investor rights and protections."

I just simply want to say I think the United States should consider on the path of high standards, of having the gold standard. It has served us well in the past. I think it will serve us well into the future.

Some say, well, you know, these IPO's are being issued on other exchanges. But then you have to look a little into that, and one of the things that is clear, when you do that, is that the major driver of the global IPO markets is the privatization of former state-owned enterprises. The top five IPO's in 2005 are all former state-owned enterprises. This trend is probably going to continue, but, there is usually political direction to list those IPO's on local exchanges. The Chinese Construction Bank went to the Hong Kong Exchange. The two other Chinese IPO's in the top five also listed in Hong Kong, and the two French IPO's in the top group listed on Euronext. I just urge the Commission to hold to its standards. I think we are going to come out ahead if we do that.

The question I want to put to the Chairman involves hedge funds, and the resources the SEC will need and be devoting to make sure that the investigative and enforcement staffs at the Commission are sufficiently knowledgeable and experienced in the activities of these funds.

Last Friday, Floyd Norris wrote an article in *The New York Times* headed: "Are These Hedge Fund Results Real?" He went on to say, "For those who favor open markets and open investment management, it may look like the best of times, but it may really be the worst, and we may not learn just how bad it is until something horrible happens. More and more trading and more and more

money now falls outside almost all regulation. Hedge funds trade with virtually no disclosure of what they are doing."

The New York Times ran a story in late March, "An anxiety about the growing power of hedge funds." "These funds have increased sharply in number, size, and effect on the market. According to stock exchange officials they constitute from one quarter to one half of all trading on that exchange every day. Hedge funds operate with a fair amount of secrecy, which naturally shrouds them in mystery, and often suspicion. Combine that with a veiled practice of shorting and the devaluation of stock research since the market collapse, and it becomes a recipe for concern." And there are a whole series of comments to that effect.

We recognize hedge funds perform an important function in the markets, but given these concerns that are being expressed, I want to ask the Chairman whether the SEC has the necessary resources and authority to understand, investigate activities in this area, and if necessary, to bring enforcement actions?

Chairman COX. The straightforward answer to the last part of your question is yes. We have been bringing enforcement actions and regulating hedge funds to the extent that some of them have been registered as investment advisers for the last decade. We are now implementing authorities under a new rule that went into effect within the last 90 days as you know.

I should bring to the attention of the Committee that as a result of compliance with that new rule, we have essentially doubled, nearly doubled the number of hedge fund advisers that are registered with the Securities and Exchange Commission, and our presumption is that virtually the entirety of those new registrations are in consequence of our new rule. This is giving us some reliable census data about how many advisers are operating within the United States that are subject to our jurisdiction, and that is one of the main things that we had hoped would occur.

We are also training our inspectors specifically for the purpose of understanding how to inspect hedge funds. This is a new emphasis for the Commission. We are devoting significant resources to it, and, importantly, we have drawn on the expertise and resources of academics and hedge fund experts as part of this training. So, I think that we are well-prepared to embark on at least this next step. And, as we internalize this new information that we are gaining from the hedge fund adviser registration, and learn from it, I think we will then be prepared with the recommendations of our professional staff on what should be next steps.

Senator SARBANES. I think it is an important process you are going through. Some of us on this Committee lived through the savings and loan debacle, and I think it is imperative that the Commission and the Committee try to anticipate potential problem areas, because once they hit, they can hit with tremendous force, have wide-ranging repercussions, and so an ounce of prevention is worth a pound of cure, and encourage the Commission in its work.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you.

Picking up on the conversation, the exchange that you have just had with Senator Sarbanes regarding hedge funds, with the sup-

port and concurrence of Chairman Shelby, Senator Dodd, and I will be holding a hearing in our Subcommittee on Securities, on hedge funds on May 16, and as you know, Mr. Chairman, you have been, or a representative of the SEC, asked to testify. I think so far all representatives of the President's Working Group will be in attendance, recognizing that there is a lawsuit challenging the SEC's ruling on hedge funds. But nonetheless, I would hope—and I know we will have an opportunity to discuss this in some detail privately this week—that the SEC will be represented at the hearing.

A couple of follow-up questions to you, Mr. Chairman, regarding Senator Sarbanes' questions. Could you give this Committee a status report on where the SEC is on the current regulation, even though it is being challenged in Federal Court? Is it still the current regulation, the regulation that in fact requires hedge fund managers to register? Has there been any change in the status of the regulation as a result of the lawsuit?

Chairman COX. No. As I mentioned, I believe within 24 hours of being sworn in as Chairman, we intended to, and we have, put that rule into effect exactly as it was written. And it did in fact require advisers to register by a deadline of February 1 of this year. That deadline has now, obviously, passed, and the result is that over 2,400 investment advisers have registered. That is, at least as of March 31, 2006, the most current data that I brought with me to this hearing.

That covers more than 11,500 hedge funds with assets of almost $2 trillion. The census information that we were hoping to acquire, I think we are acquiring in a sturdy way. I should reemphasize, as I mentioned in response to the question from Senator Sarbanes, that roughly half of hedge fund advisers had already been registered by their choice, and so, now that this rule has gone into effect, I think we have our arms around what is the true population.

Now, we understand inferentially that, because of the lawsuit, there is a small group of people who may be holding out and not registering, but I do not think that statistically that is material.

Senator HAGEL. We will have an opportunity to further engage this issue with more specific questioning when we have the hearing on May 16. Thank you.

Let me turn to a *Wall Street Journal* article, January 27, 2006. The headline is: "New York Stock Exchange Grants Fannie Request for Continued Listing." I will just set this question up this way. The beginning of the article states, "Embattled mortgage finance company, Fannie Mae, announced Friday that the New York Stock Exchange recently granted the company's request to continue listing its stock despite the fact that Fannie has not filed an earnings statement since the second quarter of 2004. The Securities and Exchange Commission approved last week a controversial amendment that saves Fannie from certain delisting procedures that were slated to begin as soon as March under the New York Stock Exchange original rules for companies that had fallen behind in their SEC filings."

"Fannie, in an SEC disclosure, filed after the markets filed Friday, said the New York Stock Exchange approved the company's request last Thursday, which is also when the SEC okayed the change."

Can you explain to the Committee why you did that, and are you concerned that this sends a very dangerous message to others? And maybe take us down into some detail as to what was the reasoning behind that approval?

Chairman COX. We do not begin with the presumption or the intention of forcing delisting. I have discussed these specific cases with the New York Stock Exchange. We are watching very carefully the promised compliance, and it appears that we are now within reach of getting what we have expected. If that does not come to pass, obviously, our approach will change dramatically.

Senator HAGEL. What do you mean getting what you expected?

Chairman COX. We have right now a timetable by which we expect that the work that was necessitated on account of restatements will be completed and the filings with the Securities and Exchange Commission will be made. We can review those per normal.

Senator HAGEL. I have to tell you, Mr. Chairman, you have presented to the panel this morning, and you took a great deal of time doing it and I think we all agree with it, a priority of being concerned for investors. And I would have a concern for investors when a public company has not presented financials since the second quarter of 2004 and is still is allowed to trade on a major stock exchange.

That would be a concern for me as an investor and one who, like you, is concerned about investors. I would strongly suggest that we need to take a further look at this. At least I would like to have a further conversation with you about this. There will be, I am sure, some additional hearings on this.

But I think this is a very serious problem aside from the fact that it sends the wrong message to the markets. And I am wondering also, which Senator Sununu got into a little bit with you and I am sure he will follow up in his time for questions, why is it that we are falling behind in IPO's here in the United States?

Is this all connected? Are we having a confidence problem? I will let Senator Sununu take that because my time is up, but I again thank you for coming before the Committee, Mr. Chairman.

Chairman COX. Thank you. I want you to know that I take, and the Commission takes, your message to heart. It is the unusual circumstance of the transition to 1934 Act compliance, and the coincidence of that with these massive restatements that has landed us in this, what I expect to be temporary, position. But, going forward, the kind of compliance that you expect is the same kind of compliance that we would expect at the SEC.

Senator HAGEL. I think when you exempt companies, you are headed for trouble, and we know that we have some trouble that we are talking about, so we will follow this up in a private conversation. Thank you.

Chairman SHELBY. Senator Dodd.

Senator DODD. Thank you, Mr. Chairman. Again, thank you, Chairman Cox, for being here today. I know you have this advisory committee on Sarbanes-Oxley, regarding smaller companies, is about to—has it reported to you yet formally?

Chairman COX. Yes, just this week, just yesterday.

Senator DODD. I am interested in hearing your initial reactions to the report. And in the context, I would like to raise two issues

that struck me as being—certainly all hearings, as Members of Congress, we hear from corporations and others in our respective States. I think probably all of us ask when we meet with a corporate executive, how are you doing, how is Sarbanes-Oxley affecting you? It is a common question. If we do not raise it, certainly they will with us when the opportunity presents itself.

I have been struck, by and large, by the positive reaction to Sarbanes-Oxley. I have heard some very good comments about the overall effect this has had on corporate governance, the effectiveness of audit committees, the weeding out of board members who were not necessarily doing a good job or serving on too many boards. They describe it as having a very salutary effect overall.

There have been some questions raised about the cost and so forth to smaller companies, Section 404 questions and so forth have come up. But I was struck in some reports that in fact the cost of compliance under Sarbanes-Oxley is actually reduced by 45 percent over the last 2 years, and that if we were to follow the recommendations of the advisory committee, as they have been proposed, some 80 percent of all corporations presently covered by Sarbanes-Oxley would be exempt. I want to know if those two facts are true and what your initial reaction is to this advisory board?

Chairman COX. As you rightly observed, we have just received this advisory committee report. I just yesterday had an opportunity to congratulate the co-chairs of the advisory committee and all of their members for a year of very hard work. I think they performed admirably in representing the concerns of small business, which are among the several concerns that we will have to take into account as we go forward.

As for the specific recommendations of the advisory committee, I will simply represent what I have previously stated, our emphasis is on making Section 404 work, and implementing it in a way that provides all the needed investor protections without unnecessary cost. This is all meant to be for the protection and the benefit of investors, and therefore, they are entitled to the maximum amount of investor protection at the lowest possible cost. We do not want unnecessary cost. We do not want make work. So we should be able to learn from early experience and implementation.

Section 404 itself is a very modest part of the overall legislation. It is just a few lines of text. The implementation through AS 2 is hundreds of pages, and the practice that has developed under that guidance is itself another gloss on the statute. But what is very important, it seems to me, is to make the statute work. So we are still in the early stages of discussing these recommendations, having just received them, and I cannot possibly represent the views of other Commissioners, since I have not had a chance to really thoroughly go through all of this with them and gain the benefit of their reactions.

I can say that certainly my goal as Chairman is to find a way to make Section 404 work, so that it should not be a question of whether to apply it to companies of all sizes, but rather how. The question you put to me also asked me to tell you whether it is right or wrong that costs are coming down. I think the answer is that some costs are coming down, and some are not. There is a dif-

ference between internal and external costs, the fees that auditors are charging as opposed to the internal cost that companies bear.

I would further observe that going forward, one would expect in a workable system that these costs will be coming down simply because the work is routinized. If there is not any routinization to this, and we keep inventing the wheel year after year, then something has to be wrong. For foreign private issuers, they are now just embarking on the front end first year costs, and so I am sure that the concern about cost is going to be with us throughout 2006 and maybe into 2007. We are aggressively going to be working implementation with the PCAOB so that we get all the benefits of 404 without needless cost.

Senator DODD. The question I raised as well about the issue of—as I understood it—and I am not suggesting this is the position you have taken—but if the full recommendations of this advisory committee were to be adopted, is it a fact that about 80 percent of the corporations presently covered by Sarbanes-Oxley would be exempt?

Chairman COX. Yes, and it depends, of course, on whether you are categorizing these companies by their, for example, market capitalization or simply counting them up. There are many small companies, and so in terms of a number of issuers you get to a very high fraction of the total. On the other hand, if you look at it from the standpoint of how big are these companies, all the biggest firms would continue to be covered even under their recommendations, and the lion's share of market capitalization in the United States. So, I think both statistics are correct and useful ways of looking at the problem.

Nonetheless, I want to get back to what I consider to be the main point, and that is that there should be a way—and the advisory committee's recommendations contemplate this, I will say— to make this work. The advisory committee report focuses on the fact that there seems to be lacking a framework applicable specifically to smaller companies, but certainly we can work that aspect of the problem as well. COSO is developing such a framework at the request of the SEC, and that may well be available as a place where we can hang our hat.

Senator DODD. Mr. Chairman, I suggest that we might want to—this is such an important issue that the Committee at some point, in consultation with you and, obviously, Senator Sarbanes and others, that we would be able to stay closely in touch with the SEC as it works its way through this. I would be very interested in making sure we had hearings and so forth on the subject matter as it progresses.

Chairman COX. I think we would welcome that. This is, after all, an agency implementation of a still relatively recent Congressional enactment, and so it is our main purpose to make sure we are doing exactly what Congress intended.

Senator SARBANES. You do have a roundtable already scheduled for mid-May, do you not, to look specifically at the question of further guidance that would come from the SEC and the PCAOB?

Chairman COX. That is exactly correct.

Senator SARBANES. With respect to the very issue we have been talking about?

Chairman COX. Our 404 roundtable is the second annual such event, and we are trying to take a look at lessons learned from one more year under our belt.

Senator DODD. Just one additional question, Mr. Chairman. It may have been raised. I apologize, Senator Hagel may have raised this, on the issue of international exchange mergers? Have we touched on that, the merger issue, the exchange mergers? Make it easier for U.S. citizens based in the United States to trade in foreign listed securities, which has some possibilities, but what entity? I am curious about what entity would then have supervisory control over the holding company, in effect, if the exchanges remain functionally regulated by the home State, if you will, or the home country?

And then on a related matter, whether or not any thought has been given to the possibility that a foreign interest could purchase a U.S. exchange? And if so, what thoughts are then—we have been through something fairly recently, not involving an exchange but something else, and whether or not we have a system set up to examine the implications of such a possible acquisition?

Chairman COX. The approach that I am taking is that this is inevitable, that this globalization is proceeding apace and is not to be ignored, whether or not, for example, the Nasdaq play for the London Exchange actually materializes. These things, these kinds of transactions in this category, will occur, and presumably, with increasing rapidity. This is just a function of the fact that these are now for-profit exchanges which have their own stock as currency to make acquisitions. They are interested in acquiring the capacity to deliver new products.

One of the key questions that needs to be answered in order to know what form regulation takes is whether in these mergers the trading platforms are going to be merged. It is entirely up to the people who structure these future transactions whether or not they subject themselves, at least under current law, to regulation country by country, or to multinational regulation.

I am taking the view that it is best for the United States and our overseas counterparts to work out some of these conceptual issues in advance before a real deal is on the table, and we know whose ox is being gored. And so the leadership of the FSA and I will be getting together for some quality time very soon. We have already met, of course, on this, but we decided we need to set aside, in a retreat as it were, more than a full day just to talk about these issues and get our minds around the problems.

I think, through hearings and otherwise, this Committee will want to do the same, because we have had a regulatory structure in this country for 7 decades that really has not contemplated any of this. Maybe it can be made to work. On the other hand, maybe it is like stretching the new facts onto a procrustean bed of regulation that just does not fit.

Senator DODD. As I said, I would rather talk about it now than have a specific case emerge and us scurrying around trying to sort it out, or condemning it because it is occurring, and then trying to write rules and regulations after the actual event has occurred.

So, again, it is one of those issues, Mr. Chairman, with a busy schedule and a lot of issues on the table, but one I would be very

interested in hearing what happens as a result of these conversations you are having and any recommendations and thoughts the SEC would have. I am sure Senator Hagel, as the Chairman of our Subcommittee, would be interested as well.

This is, again, a fact of life. It is moving in that direction. Clearly, as you point out, we should be thinking about it, and something we never contemplated in the past, but I think we had better start paying attention to it very clearly.

Chairman SHELBY. Senator Dodd, I think your recommendation and observations are excellent, and the timing could not be better.

Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

About 12 months ago, 14 Members of this Committee sent a letter to then-Chairman Bill Donaldson, urging the Commission to withdraw its proposed Regulation B, and resubmit it for comment after talking to the banking regulators on the proper scope of the regulation.

Shortly after taking office, you agreed to postpone compliance, and indicated that you would revisit the regulation. Now that you have been at the Commission for about 9 months, can you provide a report on the status of the proposed Regulation B and any effort the Commission has made to work with the banking regulators to propose a regulation that merits the legislative intent of Gramm-Leach-Bliley?

Chairman COX. I can certainly provide you with a status report. Working backward from today at 2:00 o'clock, depending on when this hearing adjourns, I am scheduled to get together with the banking regulators for the next in our ongoing series of meetings to try and hammer out a collaborative response on Regulation B.

Going back to the other end of the spectrum, I remember when I was a conferee on Gramm-Leach-Bliley, it was in a different millennium. It was a long time ago.

Senator BUNNING. Seems like.

Chairman COX. Literally was. It was a 20th century issue. We worked on it for several years during the 1990's. The law concluded, the conference concluded in 1999. It is about time that we had regulations implementing the law.

So my view is we should get this done. We can get it done, and we intend to follow Congressional intent as closely as humanly possible.

Senator BUNNING. That would be a wonderful thing if you could do that. On bonds, I understand the New York Stock Exchange Group has filed a request with the SEC to allow them to trade certain unlisted corporate bonds on its automated bond system. That would greatly expand the number of bonds that investors could trade on the exchange. When do you think the SEC will act on this application, and do you have any thoughts on the impact it will have on bond transparency for all investors?

Chairman COX. Well, to answer the first question first, I think that we can reach a resolution to this issue in the near-term. With respect to the more general question, we share the concern of the Bond Market Association and others that the industry not be burdened with duplicative trade reporting for securities traded on the NYSE's automated bond system. The Commission staff is currently

discussing with both the NASD and the NYSE the best way to address the duplicative reporting issue, and that is the basis for my confidence that we can resolve this very quickly.

Senator BUNNING. Last, but not least—because there are others waiting—proposed rules on online availability of proxy materials. The Commission has proposed a rule that would allow companies to provide shareholders with annual reports and proxy statements only online unless the investors ask for printed materials. Today, many investors, particularly the elderly and low income, do not have access to the Internet, nor do they feel comfortable doing their financial business online. We do not want to discourage investor participation, and I know many comments were filed expressing concerns about the options proposed by the Commission. What is the correct balance between increasing investors' participation and cutting the cost of shareholders communication, and how can the Commission accomplish both goals? Are there other options that are being considered after the comment period for the rule ended?

Chairman COX. Well, as you would expect of us, we are taking thoroughly into account the comments that we received, and I can say, having been through many of them myself, that there are some good suggestions in there that will help us address some of the problems and the concerns that have been raised.

When it comes to balancing the interests of investor protection and trying to save money on sending them disclosure documents, I have to say that I put by far the greatest weight on the former and very little on the latter. It has been pointed out there might be some cost savings if we move to electronic delivery rather than paper delivery. But that is not the reason that I would support it.

What I am interested in, as I mentioned in my opening comments, is making the disclosure useful to customers. And if what the customers are getting right now is a long document written in legalese that they throw away, then we are not doing the job. We have to find ways——

Senator BUNNING. That is what we are getting.

Chairman COX. Exactly. We have to find ways to turn this into what it was supposed to be all along, and that is user-friendly information from a customer standpoint. If the customers are throwing away your product, you have to ask yourself what is wrong with your model.

When it comes to seniors, and particularly because this is such a focus of our efforts now at the SEC, we are looking at a number of issues. First of all, for people of very advanced age, many times the issue is not whether it is electronic or paper, but who is managing that money, and is there a caregiver involved, and can we find someone there that is authorized to deal in their behalf, and have we got people selling things to people who are non compos mentis? That is a big opportunity for fraud, and we want to make sure that, as more and more of the Nation's assets are held in that way, it does not come back to bite us.

We will never get away from paper delivery. There will always be paper delivery. Some people, sometimes me, but some people always prefer paper to electronic delivery for a variety of reasons. We want to make it as easy as it can possibly be for people to get the information in whichever form they want. And so, as we go forward

with this final rule, we want to make sure that we do not have so much of forced opt-in or -out as a painless way to get your choice.

And to make sure that if it were possible—actually, one of the things that we are thinking about is, is it possible—we do not know quite yet if it is possible—but, if it were possible, could you call one number once for everything you own, and say, "I just want it in paper." That would be a lot simpler than having to do it with every single security that you own. One of the comments we received is, "Find a way to do that," and we are looking to see whether that is possible.

Senator BUNNING. Thank you.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thank you, Mr. Chairman.

Chairman Cox, it is great to see you. Welcome, and hope you are doing well, and we appreciate your being with us today.

In reading your testimony, sometimes you read these testimonies—you have read a lot of them in your time as well—and say, what are they trying to say? And every now and then we come across testimony that is as clear as a bell. It is interesting too, because in your testimony you talked about among the things you are trying to do is to move from boilerplate legalese to plain English in every document intended for retail consumption. And I just want to say it is great to know that in your statement today, it is very clear, it is well said, even understandable to a recovering Governor from Delaware, so I thank you for that.

You mentioned in a section here in your testimony, talking about making disclosure understandable for ordinary investors. I am going to be down in Salisbury, Maryland later this evening, Senator Sarbanes, and your hometown, and they are having the Annual Delmarva Poultry Dinner. It is a big dinner, as you know. I want to talk to the people that gather there, a couple thousand people gather from all over the Eastern Shore, Delaware, Maryland, and Virginia. I want to talk with them about some things that we have been doing with respect to getting a greater effort from the U.S. Department of Agriculture to help us ensure that we are doing a better job of testing chicken flocks for avian influenza.

My staff gave me a statement, a speech they thought I could give, and it sounded like a speech that was written by somebody right here in Washington, who had never been to a poultry farm, maybe not even eaten chicken.

[Laughter.]

So, I gave it back to them and I said, "I am going to be speaking to hundreds of farmers, poultry farmers, and I want to have something I can explain that they will understand." So when I read this part of your testimony, it just really rang clear with me.

You speak to, in the first part of your testimony, about executive compensation. And you say very plainly that some executives, CEO's, deserve every penny they are paid and probably more, and frankly, some do not.

I came across a story recently about a big company in this country where the CEO was paid a large amount of money, and the article examined the firm that is retained by this big company, who

come in and recommend, among other things, compensation for the CEO. And then it turns out that this firm who recommends compensation for the CEO, also has a big consulting contract with the whole company, and to the extent that it is worth a whole lot more than the value of their making recommendations for the CEO's compensation. It turned out the CEO serves on other boards, where the other people from the other companies, these boards he serves on, serve on his board, and he is on the compensation subcommittees of these other boards. It just struck me, I think an ordinary person looking at this would just say this does not pass the smell test.

And I do not know if you are familiar with the situation I am talking about. I am sure that it is not by itself. There are probably a number of those. But just your reaction to that kind of thing, and what you and your colleagues at the SEC are trying to do about it?

Chairman COX. The independence of compensation committees is key to solving the problem that you described. I have to say, even before I jump into this, earlier when you mentioned that you were given a statement that looked like it had been written by somebody in Washington who had never eaten chicken, I was going to say that my experience in Congress is there are very few people who have not had a chicken dinner.

[Laughter.]

There are also few enough people who write in clear, plain English, so I appreciate your remarks with respect to what we are trying to accomplish for customers at the SEC there.

When it comes to executive compensation being determined fairly in the interest of shareholders, obviously, the SEC's main tool is disclosure, and we want to make sure the market works the way it is supposed to work, on the basis of clear understandable information, the best information obtainable. The compensation committees of the boards are the people that the shareholders rely on to do this job well.

In a situation such as you describe, where we might suspect, because of conflicts of interest, the board is not doing its job, how can the shareholders know for sure? So putting those tools directly in the hands of the shareholders as well as the compensation committees is a way to provide a check and balance.

If there is the greatest possible degree of transparency in the marketplace, and if there is the very best information, then not only the shareholders, but also the directors, can be expected to do a better job.

Senator CARPER. I commend you for your commitment to being plainspoken, and to making sure that the people who work with you are too. I commend you for your focus on executive compensation, and to make sure that the old adage that we treat other people the way we want to be treated and that we remind boards and people who run these companies, that there is a reasonable expectation that they should do that too.

And I commend you for your commitment to trying to get the SEC, the five Commissioners, to be more collegial and to look for common ground so that when you come forward with your rec-

ommendations, that you find that you are more unanimous than less.

Thank you.

Chairman COX. I have to say when it comes to executive compensation, I am also trying to lead by example. As Chairman of the SEC, I have over 800 people at the Agency that make more than I do.

Senator CARPER. You are a great role model there.

Senator BENNETT. [Presiding.] Senator Sununu.

Senator SUNUNU. Thank you.

Chairman Cox, Senator Hagel brought up the change in the New York Stock Exchange rules. They were changes that exempted a single company, Fannie Mae, from their mandatory delisting proceedings. And it was done largely on the basis of the market capitalization of the firm. I think your answer was effectively—well, we hope that they can move forward and get this restatement issue done in the near-term. And we all hope that, but the fact is the Exchange had very clear procedures regarding delisting and they chose to craft an exemption for this one firm.

And basing it on the overall size of the market capitalization begs the question, well, what happens when a similar exemption is sought for Exxon or for General Electric or for Google or for Philip Morris or for any one of the companies that have a larger capitalization than Fannie Mae? Is the SEC going to agree and concur that this is a good idea when a similar exemption is sought for other firms that might be larger than Fannie Mae?

Chairman COX. No. This is, in my view, sui generis because of the coincidence of the initial subjection of this Government Sponsored Enterprise to the reporting requirements of the 1934 Act and their massive restatement. Getting them online, getting them to be subjected to the Exchange Act, represents a significant change that has been, as you know, the subject of considerable legislative as well as Agency attention.

Senator SUNUNU. It is my understanding that the delay in their filing of reports is not necessarily related to their compliance with the 1934 Act. These are their financial statements that have to be restated because of significant discrepancies and irregularities in the way certain transactions were accounted for. We have the findings of the Rudman Report that certainly validate those concerns. They had much more to do with irregularities in the accounting process and attempts to manipulate earnings than any specific changes that come as a result of their participation in compliance with the 1934 Act.

Chairman COX. Well, as you know, the timing of this was as follows. Fannie registered under the Exchange Act and became a reporting company for the first time on March 31, 2004. Their last periodic report was their Form 10–Q for the quarter ended June 30, 2004, that was filed August 9, 2004. And it was September 2004 that OFEO issued their preliminary report about Fannie Mae's accounting practices that led subsequently to Fannie seeking guidance from the Commission and our accounting staff regarding several of their accounting matters, including deferred purchase price adjustments and derivatives and hedging activities and so forth.

It is that confluence of events to which I refer that I think makes this different than, for example, a Google or any other recently public company.

Senator SUNUNU. I appreciate the point you are making, but I think it is a stretch when these are irregularities that occurred in 2001, 2002, and 2003 and they are irregularities that would have delayed or forced a restatement of earnings regardless of their decision to comply under the 1934 Act in 2004. Senator Hagel made the point that it perhaps sends a bad message to investors, to other participants in the market. And I am equally concerned that it establishes a very bad precedent, because when you base the exemption, as was done—I do not think the language mentions timing or changes or applicability of the 1934 Act.

The *Federal Register* does not mention that: Standards apply only in certain very rare circumstances where the Exchange determines that delisting would be contrary to the national interest and the interest of public investors—due to the filer's position in the market, *i.e.*, the nature of its business and its very large publicly held market capitalization.

That is the *Federal Register* from January 26, 2006.

So if this rationale had been presented by Fannie Mae or by the Exchange, I might be a little bit more sympathetic. But I do not think that is the argument that was made, and that is why I have concerns about the precedent.

Chairman COX. But I just want to say, I agree with you that it cannot simply be the question of size and if you are of a certain size then you get a pass.

Senator SUNUNU. I appreciate that clarification.

Final question on market data. The SEC has been looking at this issue well before your time. They had a concept release in 1999, an advisory committee in 2000; they proposed some changes to the way market data was dealt with in 2004 as part of Regulation NMS, et cetera, et cetera. Where does this stand? Can you commit to or talk about the Commission's determination to finally come to some conclusion on the question of market data, collection of revenues for market services, and the allocation of those revenues?

Chairman COX. I cannot tell you definitively how this is going to turn out, but I can tell you that it is a subject of intense focus, as you might expect. In the for-profit world, this is a source of potential ongoing revenue. At the same time, we want to make sure in the maintenance of orderly markets—one of our chief missions at the SEC—that we have the maximum amount of transparency. We also have correlative issues in the ongoing implementation of Regulation NMS. And so I think you can rest assured that this is on the front burner, but I feel as if I cannot tell you definitively at this moment how it is going to turn out.

Senator SUNUNU. I appreciate that, although, to be clear, my question is not how will it turn out; my question is, is there enough focus to ensure that there will be some resolution, some decision, some determination, which, you know, has not been achieved, has not been implemented in the past. And I very much appreciate your point about——

Chairman COX. And my answer to that question is absolutely yes.

Senator SUNUNU. I appreciate that. And to your broader concerns about transparency, I think this falls right into those sets of issues because some of the existing structure of the market data revenue collection distribution system can perhaps encourage people to break up orders—you know, take a 1,000-share order, break it up into 10 different 100-share orders—in order to effectively distort and maximize a firm's benefit from the allocation and rebate schemes that are inherent in the current system.

So from the transparency of both the regulator and an investor, I think there are improvements that can be made that would eliminate incentives to manipulate the trades and that would improve the transparency of trades that are occurring.

Thank you very much.

Thank you, Mr. Chairman.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you.

Several items. Chairman Cox, thank you for being here and welcome to your first experience. I hope we have a lot of subsequent ones and that they are all pleasant.

I heard the conversation about Sarbanes-Oxley. My experience during the break was not the same as Senator Dodd's. I had some venture capitalists tell me flatly they no longer do IPO's and Sarbanes-Oxley is the reason. And if it becomes necessary for them to take a company public or—"necessary," if it is the logical thing—they look to do it at some foreign exchange rather than in America. So as you do your analysis of the reports you have, this is anecdotal, there is nothing scientific about it, but it is a different kind of constituent response than the one that Senator Dodd——

Chairman COX. I appreciate that it is anecdotal. On the other hand, I was speaking up at Harvard University recently, Harvard Business School, to a group of venture capitalists who expressed precisely the same views.

Senator BENNETT. Okay.

Chairman COX. But that was also anecdotal.

Senator BENNETT. Right.

Chairman COX. There are now two——

Senator BENNETT. Okay, well, I heard Senator Dodd say he found nothing but good comments about it, and I had heard some of the other kind.

Let me move to a subject that I have been on for some time and begin my remarks by saying that the SEC staff has been responsive. I have been talking about this for maybe a year or more, and they have, staff members have been in to see me, but the problem still exists. We are talking about naked short selling and the problems connected with that. One of the things that I have been told that I want to lay down and say I think this is an immaterial excuse, when they say but you get 99 percent settlement and the FTD's are only in 1 percent of the dollar volume and therefore it is not really a big deal.

You made the comment earlier with respect to Sarbanes-Oxley that you got 80 percent of the companies that might be made exempt but, if you look at a market cap, it will be very large. That same dichotomy exists with respect to the naked short selling. I got

into this because I had constituents that had little companies, and for them it is a huge deal. And many of them insist that they have been destroyed by it. That is, the naked short sellers keep hammering their stock until finally they cannot raise any money, the company goes under, and nobody every has to cover. And I do not know that that is the case. Again, this is an anecdotal accusation that is made. But if indeed it is true, it is a demonstration of market manipulation that is not only clearly illegal, but also devastating to people who form companies and then try to turn to the markets to raise money and cannot because the shorts keep hammering them.

I want to make it clear also, I do not think short selling is improper. I have sold short in my investment life. Usually I have been burned by it, but I have done it. And the broker that handled it gave me the old statement, "He who sells what is not his'n must buy it back or go to prison." And apparently, some of these people are not buying it back. I always had to when I sold short.

And it has gotten into the news again. I started doing this because, as I say, I heard from very small companies who were my constituents, and their stocks were traded on the pink sheets. And it looked like nobody cared on the pink sheets and they could hammer companies there all day long with naked short selling and nobody would look at it. And that is the thing that I raised with the SEC before.

Well, now it is getting a little more currency. There is a piece in *The Wall Street Journal* on April 13. The headline says, "Despite SEC Rules, the Small Amount of Naked Shorting Appears to Persist." And in that article, they talk about companies that have stayed on the list for months and months, on the list where the FTD's have not been cleaned up. *Overstock.com,* Martha Stewart Living Omnimedia, Inc., and Krispy Kreme Doughnuts have been on the threshold list for months. *Overstock.com* happens to be located in Utah, so that caught my eye.

Then, on April 12, *Forbes* had a piece about short selling in hedge funds and how they felt that they were being taken advantage of. The latest *Bloomberg* has a piece, not specifically on short selling, but entitled "Corporate Voting Charade," and says that the people who buy shares to sell them short then get involved in proxy fights and that people end up voting shares they do not own. They have borrowed the shares for short-selling purposes and then vote them when they really have no interest in the long-term health of the company.

And there is an interesting chart in the *Bloomberg* piece about how some close corporate elections were decided by the voters of the short sales, and says that Alaska Air Group, the short sales were 4 percent of the voting and the winning votes were 2.4. MONY Group, 6.2 percent of the votes were in short proxies and the winning margin was 1.7. And El Paso, 76 percent were short votes and the winning margin was 17.2. And there are those who say this whole situation cries out for more SEC oversight and attention.

So let me, with that, ask you the question, If you cannot answer it here, would like a response for the record. There have been a lot of companies that—well, "a lot," several, we will say "several" com-

panies have been on the Regulation SHO threshold list for a very long time. And one of them, as I say, is one of my constituents. Presumably, at least some of what has led these companies to be on the threshold list for so long is illegal short selling. So, I would like to know, as you examine the list, are you willing to use your authority to have the SEC continue its pursuit of basic transparency by requiring the disclosure of the amount of FTD's?

Chairman COX. Well, you covered a lot of ground.

Senator BENNETT. I apologize. Maybe I overwhelmed you here.

Chairman COX. I am trying to keep track of all of it.

Senator BENNETT. We will be happy to provide you with pieces of paper on all of this.

Chairman COX. Of course, I will take advantage of that as well.

Senator BENNETT. Sure.

Chairman COX. To start at the beginning and end at the end, the experiences that you described, some of them your own and many more that you have been apprised of by your constituents and others, are experiences that in some respects I have shared. When I first came to the Congress in 1989, I served on a subcommittee chaired by then-Chairman Doug Barnard, of Georgia, of the Consumer, Commerce, and Monetary Affairs Subcommittee. That subcommittee focused for several months on bear raids and short sellers and what was going on in that industry.

I share completely your approach to this problem, that short selling is a component part of healthy markets, one that is perfectly respectable; and, indeed, it is an important check and balance in our system. From the standpoint of orderly markets, it is vitally important that shares be delivered. These are contracts, and they have to be fulfilled, and there has to be a rule of law.

I also—moving to your next point—agree with you that it is faint comfort for someone with a microcap company to hear that statistically we are doing great, that we are reducing these failures to deliver and that life is much better now than it has ever been before because statistically we can prove it so. In a thinly traded company, life is different. So enforcing these rules in very different circumstances is also vitally important.

Having said that, I do think it is important to recognize the progress that has been made under Regulation SHO, which the Commission, as you know, adopted in 2004, before I became Chairman. That rule became fully effective in January of last year. It has a modest ambition. It is designed not to eliminate but to reduce failures to deliver on short-sale transactions and to target potentially problematic short-selling—abusive naked short selling.

What I can commit to now is that, when we have internalized and understood the results of our examinations, which are now ongoing, of compliance with Regulation SHO, and we have completed the examinations of some 45 firms that include comprehensive target exams of 19 clearing firms, I will recommend changes to our rules if those exams demonstrate that changes are necessary for the reasons that you describe.

Senator BENNETT. Let me just conclude, Mr. Chairman. I applaud what you are saying and I am sure you will go forward with that. Picking up on what *The Wall Street Journal* had to say with these three companies that are listed, that have been on the list

for months, that might be one of the places to start. The company stays on the list for months, that is an indication to me that there is something going on that is unusual. I can understand an FTD, I can understand a flood of FTD's for a variety of benign reasons. But when a company is on the list 1 month, that says, well, okay, there are just some problems. When the same company is on the list for 2 months, well, maybe something is going on we need to pay—when it is on for month after month after month and catches the attention of publications like the *Journal,* I think that should be a rather informal but strong flag that says we should pay attention at least to these companies to see why they keep showing up on the threshold list.

Thank you very much.

Chairman COX. Thank you very much, and I hope to be able to follow up with you on these things.

Chairman SHELBY. [Presiding.] Thank you, Senator Bennett.

Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman, and thank you, Chairman Cox, for being here. Glad to see you are on top of all of these things.

I have a whole bunch of questions on cats and dogs here, but one I know you have been asked about. I would just like to underscore my concern here as a New Yorker, that so many of the IPO's, none of the top 10, one out of the top 24, have not listed in the United States. In 2000, 9 out of 10 listed in the United States. And as I understand it, some people have asked you a little about that, but obviously I hear from somebody whose goal is to keep New York the financial capital of the world. That troubles me.

What can we do about it? Does it worry you, I guess, is the first question I have, and what can we do about it to try and change it? Is it temporary?

Chairman COX. All right, let me begin by saying that I share your objective.

Senator SCHUMER. Thank you.

Chairman COX. The U.S. capital markets are today, and certainly have been for some time, the largest, deepest, most liquid in the world. They are also—and, I believe, not coincidentally—subject to the highest standards of quality in the world.

Senator SCHUMER. Right.

Chairman COX. It was remarked upon, I believe by Senator Sarbanes earlier, that some studies show that there is a quality premium that companies can demand when they list in the United States.

That is the way strategically, I believe, the United States should continue to approach our role in the world's capital markets. Rather than participate in a race to the bottom that surely, in terms of comparative advantage, we would lose, it should be our objective to work together with other high-standards countries to make sure that that is the way the world goes as increasingly there are more global markets.

It is a fact of life that the domestic markets of other countries are becoming rather rapidly more mature. And so I do not think that by birthright the United States can lay claim to every large issue by every foreign issuer. But we certainly are entitled to our

share. And certainly, if we are correct in our view that our markets are in fact the most liquid, deepest, largest in the world, we can expect that countries will want to come and list here for precisely that reason and to gain that premium the price premium that they should be getting.

Senator SCHUMER. Right. But they are not coming now. I think we all agree with that. In an international world there is a delicate balance, obviously. You want to strike the right balance. It is just the change has been so dramatic over 5 years. Five years ago, we were also the most highly regulated. Could it just be that others are catching up in sophistication? And why are people not still willing to pay that little premium so their investors worldwide know that they are being well-regulated? It is a troubling phenomenon.

Chairman COX. I agree with you that we need to keep our eye on this ball. And to the extent that the perception exists, and I believe that it does in Europe and elsewhere, that the costs of regulation and of litigation in the United States are comparatively unpleasant and they would like to sell themselves, comparatively, as better in those respects, we need to do everything that we can to make sure that we achieve our objectives of high standards without unnecessary costs. And that is something that is all in implementation. It is perhaps some art as well as science. But it is what we aim to do at the Commission, to make sure that investors get every ounce of protection that we can give them at the lowest possible price.

Senator SCHUMER. Right.

You know, the cost issue troubles me some because for a smaller company, you get the estimates, $15 million, $30 million the first year, but for a huge billion-dollar company, I mean, $30 million is still nothing to sneeze at, but it seems a small price to pay for the Good Housekeeping Seal of Approval, if you will.

So, I cannot believe it is cost, at least for larger companies, that keeps them away. It has to be something else. Now, somebody suggested to me, and I do not know where I would come down on this, that their directors do not like to be under the kind of extra scrutiny that they are here now. Could that be a possibility? Or "extra responsibility" is a better word than "scrutiny."

Chairman COX. Yes, I think expressed in that way and understood through the prism of liability, it may well be that human beings, particularly the human beings in control, have an affective as well as quantitative response to——

Senator SCHUMER. Which might not be good for their companies but might be better for them.

Chairman COX. Yes. To some of these questions. You know, to the extent that what we are trying to do here is for the benefit of shareholders—eliminate conflicts of interest, maximize transparency—I think that eventually it will be seen for what it is, as an advantage to the people whose money we are talking about. And so, I do not think we need to hesitate at all in our drive to constantly reinforce our high standards in this country. We do need to make sure that, as we implement those high standards, we are doing it with the interests of investors in mind.

And it is their money. So, if we are wasting their money on needless complexity, some of what I talked about here earlier today, if

the rules are being implemented in a Rube Goldberg way, if we have an instinct for the capillary instead of the jugular, we can fix those things.

[Laughter.]

But we do not want to miss the main point. And so to the extent we were talking about, elliptically here, Section 404 or Sarbanes-Oxley, I want to get back to my main point of emphasis, which is I was a conferee on that legislation, and I worked with many of you to put it into force. I think we can make it work in a way that causes people to want to list in the United States and that causes investors to insist on those high standards.

We are seeing some of that right now. We are seeing some of Sarbanes-Oxley imitated in other countries, in other regulatory regimes. So, I do not think we have to be supine here and not fight back when it comes to standing up for ourselves.

Senator SARBANES. Chuck, would you yield for a minute?

Senator SCHUMER. I would be happy to yield.

Senator SARBANES. There is this—I mentioned earlier, Ernst & Young has done this third annual report on global IPO trends, which is pretty interesting. And the two trends they point to that have an impact on all of this is, one, that a major driver is the privatization of former state-owned enterprises and that there is a lot of political direction or pressure when that happens for it to be done on the local exchange. Like the Chinese do it in Hong Kong, the French do it on Euronext, and so forth.

The other point they make is the increasing pools of capital that are available elsewhere around the world, and so, the capital is not just in the New York market, it is to be found in other places.

And third, some of the exchanges abroad are making a bald pitch that they have less regulation. You know, come to us, we are not as——

Senator SCHUMER. We have that here in America, too. Some of them are doing that.

Just one quick other one. Soft dollars, where the SEC has been making progress and you have been moving forward on it, but the question I guess I have is very simple. And that is when will the SEC issue a final interpretive release? Things were moving along nicely and now—are there bumps in the road now, or is there any reconsideration——

Chairman COX. No.

Senator SCHUMER. What is slowing it down?

Chairman COX. No, in fact we are on the threshold of action.

Senator SCHUMER. You are?

Chairman COX. Yes.

Senator SCHUMER. Good.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Chairman, what is the state of mutual fund disclosure today, and are we obscuring truly important information by requiring the disclosure of so much information that is basically boilerplate in nature? Is that a concern sometimes? You spoke about it earlier.

Chairman COX. This is a central focus of our effort to make things better for retail customers. Because, as you full well know, for retail customers mutual funds are the investment of choice.

Chairman SHELBY. We have nearly 100 million Americans investing one way or the other.

Chairman COX. Precisely. And so, if there were any area where we were going to focus our efforts—on plain English, on information that consumers can understand—it would be here. This also is an area where we are, early on, focusing our efforts on interactive data. And I will say that the mutual fund industry and the Investment Company Institute have been willing partners in this. Very recently they have committed to finishing writing the taxonomies necessary to present information to consumers within interactive data.

I am tempted to go off on a riff about all the potential benefits of interactive data, but that might be a topic for another hearing. Suffice it to say, directly to your question, that we can do a lot to make mutual fund disclosure more useful to investors. And using the Web and letting investors find what they want, letting intermediaries and analysts who prepare information for retail customers more easily compare what is in funds, which interactive data helps with, all is in the offing.

Chairman SHELBY. Nothing like an informed customer, is there?

Chairman COX. That is what makes markets work.

Chairman SHELBY. In the area of accounting, convergence of accounting standards, which are very important, I applaud your efforts to harmonize the international financial reporting standards and U.S. GAAP. In my view, this endeavor will greatly benefit the global capital markets, as we have been talking about. Could you provide the Committee with an update on this multiyear project now, or just for the record?

Chairman COX. I would be happy to do a little of it now and further for the record, if you would like.

In October of last year, IOSCO announced plans for creating an arrangement for regulators to consult and share information on their decisions regarding the application of International Financial Reporting Standards. One end product of this project will be a database for cataloging interpretations and decisions that will help us improve cross-border enforcement of the application of these standards, and work is continuing on the development of that database. It is anticipated that IOSCO is going to launch this in the second half of this year.

In February of this year, the FASB and the IASB announced an MOU, which outlines their topical priorities and related anticipated deliverables, in their efforts to further their standards-setting work to converge the provisions of U.S. GAAP and IFRS. And that MOU covers work that is planned to occur between this year and in 2008.

Beginning in the second half of this year, the SEC staff plans to begin reviewing the 2005 IFRS financial statements and accompanying U.S. GAAP reconciliations filed with the SEC by approximately 300 foreign registrants. That in turn is going to help inform the SEC staff as to how IFRS is being applied and practiced by those registrants. To keep us on the road map, we want to make sure that there is a consistency in application both within industries and across national boundaries.

Chairman SHELBY. Mr. Chairman, Sarbanes-Oxley. In your view, which provision or provisions in Sarbanes-Oxley have had the most impact on corporate governance and financial reporting?

Chairman COX. I hesitate to pick my favorite because that might sound like faint praise for all the rest.

Chairman SHELBY. To my colleague sitting here.

Chairman COX. Exactly. Let me come at the question from the other end and take this advisory committee report that we just received on Monday. It is instructive to read that report and to find in it, coming from advocates for smaller public companies, a fairly ringing endorsement of virtually every provision of Sarbanes-Oxley. They have a great deal of focus and concern on one section, on 404, but I think, for companies of all sizes and for companies within and without the United States, essentially all the rest of Sarbanes-Oxley is proving to be of salutary effect.

Chairman SHELBY. Senator Sarbanes. Oh, Senator Crapo has not had a round yet, I am sorry.

Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman.

I apologize. I have had to step out of the meeting, so I am glad I got back before they cut you loose, Chairman Cox. I first of all want to welcome you here. I remember when I first sat together with you on the Commerce Committee in the House, and I have enjoyed the opportunity to work with you on many different issues and in many different contexts. I am very pleased that you are now the Chairman at the SEC.

I did want to get back to address one issue. I found out as I got back that Senator Bunning already raised it, and that is Regulation B. I understand from what Senator Bunning brought up with you that you are meeting with banking regulators later today on Regulation B and you are going to be working on the issue. So, I will not go into the whole thing because I know you have already done it in the hearing today.

I just wanted to pursue one other aspect of this, and that is I have been concerned enough about this issue that I have concluded that we probably need to have some additional legislative direction provided on the issue. And as I am sure you are aware, I am working with Senator Shelby, Senator Sarbanes, and others on the Committee on a regulatory relief package for our financial institutions. It is my intent to see if I can work with Senator Sarbanes and Senator Shelby to come up with an acceptable approach to provide further legislative guidance on how to address the issue.

And so the main purpose of my wanting to get back here to talk with you about that is to ask if you would be willing to work with us, especially after you have had this meeting with the other regulators and people that you are working with on it, to help us to craft the right approach in the regulatory relief package that we are working on.

Chairman COX. By all means. If the Congress chooses to enact legislation in this area, rather obviously we would follow it to a T. In the process of developing such legislation, if you choose that course, we would be happy to make our professional staff available

for technical support. And as Chairman, I would be happy to discuss the aims of any of this with you.

In the meanwhile, we have a relatively new—although it is hard to call a 1999 enactment new for much longer—legislative enactment. But it is new in the sense that we have yet to adopt rules under it. It is my view that it is high time we did so. So, I intend to see if we cannot make this work in the short-run.

Senator CRAPO. I appreciate that and I certainly believe that you should continue to pursue the avenue of the rulemaking process in terms of improving it. As you know from the letters that many of us sent to the SEC, to your predecessor, actually, at the SEC, and then from the activities of many of us, I have a high level of concern about the current proposed rule and the negative impact that it will have. So that is one of the reasons that I have concluded that, after waiting for so long to see if we could not get something resolved, that we need to provide further legislative guidance.

But also, I encourage you as you work on the rulemaking side of it to please pay attention to the issues that we have raised and see if we cannot move forward in a way that does not create the kinds of burdens and unintended consequences that we have suggested are lurking in the current proposal.

Chairman COX. You mentioned that you and I sat next to each other on the Commerce Committee. When we did so back in the 1990's, we were working on this issue. So, I think it really is high time for us to implement the rules.

Senator CRAPO. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. I just have a couple of questions, Mr. Chairman. I do want to follow up on Senator Crapo's question just to say that we know Chairman Cox well and we have seen his skill in the Congress of being able to develop a consensus and move complicated and difficult issues through the Congress. And as I understand, he is undertaking that role on this Regulation B issue in terms of interacting with the other regulators. So, I think it is a welcome and important initiative on the part of the Chairman.

I wanted to ask about the money laundering issue, which is something this Committee has spent a lot of time on. It has been very much the focus of attention by the Chairman. We feel particularly keenly because the September 11 Commission recently evaluated all of the different areas on which they have made recommendations as to how our Government was doing in those areas. And the only issue on which they gave up an A-minus was on money laundering and terrorist financing. We think there is even more to be done, but at least we keep pressing that issue.

A year and a half ago the Federal banking agencies and the Financial Crimes Enforcement Network, FinCEN, executed a memorandum of understanding to ensure better coordination and information sharing on the critical issue of Bank Secrecy Act compliance. I think it is fair to say the Committee pushed very hard to get that memorandum of understanding. And FinCEN has since advised us they are executing similar agreements with State banking agencies.

The first question, it says FinCEN approached the SEC about executing an information sharing agreement about the results of Bank Secrecy Act examinations involving brokers and dealers in securities, and if so, is the SEC planning to execute such an agreement?

Chairman COX. Well, the answer to both questions is yes. Our staff are quite close, in fact, to reaching an agreement in principle with FinCEN which will then come to the full Commission for its approval. And, in the meantime, the staff have been having regular meetings and sharing information with FinCEN, including the results of examinations we propose.

Senator SARBANES. Second, on the Chairman's question on convergence with the international financial reporting standards. I agree with the Chairman in that it is desirable to achieve convergence, but I think it is important to do so moving the standards upward and not downwards. I know in the EU—well, let me put it the other way. The International Accounting Standards Board, I think, Sir David Tweedie and others take the same approach, so I am hopeful that out of that would come that the convergence would be achieved at a higher not a lower level. And I think that is a very important objective to keep in mind.

I do want to—we focused on financial literacy here. I know you have emphasized that issue down at the Commission. And I want to underscore its importance. Every survey just gives the most distressing results about the degree of financial illiteracy, particularly amongst our young people. Although, as you point out, seniors end up getting exploited in a very different way, and I welcome that initiative you have taken in that area. But what is your view on the financial——

You know, we set up the Financial Literacy and Education Commission to bring all the Federal agencies together to develop a program and carry it forward and then develop cooperative arrangements with the States and nonprofits, many of which work in this area—some of which have quite good programs, others not so good. What is your take on this effort, or this initiative?

Chairman COX. This is a priority not only for the SEC, but also for virtually every financial agency in the Federal Government and for the President's Working Group. And under those auspices the FLEC report was recently approved. The SEC for its part is doing a fair amount through our Office of Investor Education and Assistance to spread the word not only through our website and through the provision of educational materials, but also through seminars and cooperative efforts that we put on with community organizations around the country. And as you pointed out earlier, Senator, a good deal of this focus has also been on our men and women in the armed services.

Senator SARBANES. Yes. Finally, Mr. Chairman, since we have been talking about 404, I cannot resist a final comment. All the statute does, it has two short paragraphs, as Chairman Cox noted earlier. One says if you are a publicly listed company you have to have a system of internal controls. Presumably, if you talked to someone who wanted to list or was trying to get you to invest in their company, you said to them, well, how is your system of internal controls; and the person says, well, I do not believe in a system

of internal controls, I do not have one. You would say, hey, now, wait a minute. What kind of operation is this?

The other paragraph says that the system of internal controls has to be certified as being adequate, appropriate—I forget the exact language. And of course that is designed to make sure you do not have a phony system of internal controls.

In that arena, there is considerable discretion in the PCAOB and the SEC in terms of developing the protocols that are appropriate. And it seems to me that that is where the focus should be in terms of addressing these issues that are being raised. The proposal for a total exemption would take out of the system a very significant number of companies, 80 percent.

Many of the studies show that some of the worst abuses occur in smaller companies, not large companies, the number of restatements. We get these letters that come in over the transom from people who say I have been reading these proposals to exempt the smaller public companies, I used to work for a smaller public company, whatever you do, do not exempt them, they need to have some routine that improves their operations. And of course the Commission last year held a roundtable and gave some guidance, and you are going right back at it this year, in the middle of May, with a further roundtable.

It is being looked at. I think the fees still remain too high, but they are coming down. You had a situation where a lot of people were not up to standards. They in effect had to make an investment, almost like a capital cost, in order to set the system up. Presumably, once set up, in subsequent years it will not be as expensive. And I think we have to work through that system. I know you are hearing a lot about it, but I want to leave you with that observation.

Mr. Chairman, thank you. And I thank Chairman Cox.

Chairman SHELBY. Chairman Cox, it is my understanding that you will be coming back next month to the hearing dealing with financial literacy. You will be appearing with Secretary Snow and Chairman Bernanke. I hope then that we can get into more depth on the issue of financial literacy. We think it is very important.

Oh, Senator Schumer again. Second round.

Senator SCHUMER. Thank you. Another two quick ones on issues of some importance here.

Chairman SHELBY. Okay.

Senator SCHUMER. One, this is about credit rating agencies, also located in the great City of New York. First, I saw that the Commission recognized the First Amendment issues when they had the interaction between the SEC and journalists. I thought you handled that well, Mr. Chairman.

We have similar issues with some of these rating agencies, where people will threaten to sue them, you know, to threaten them, bamboozle them, push them around and stuff like that. They need to be strictly regulated. They need to make sure there is no conflicts of interest. But on the other hand, they cannot be cowered for making an independent judgment that somebody might not like.

So the first question I have on this is, what steps should the Commission take to show the same kind of sensitivity you showed

with reporters about these agencies in terms of First Amendment ability to say what they really come up with?

Chairman COX. Well, it goes without saying, I would hope, that neither the Securities and Exchange Commission nor any arm of Government, Federal or State, should be intruding upon the independent judgment of these credit rating agencies. That is what we expect them to be exercising.

Senator SCHUMER. Right. I am more worried about private people pushing them around a little bit.

Chairman COX. At the same time, you know, to the extent that we can do so, we need to be completely supportive of the agencies vis-á-vis all comers in the exercise of that independent judgment.

Senator SCHUMER. Right. Okay.

Let me ask you this, because they are opposite sides of the same coin, obviously, if they are—if everyone thinks they are fair, impartial, on the level, they have more protection built in. So the rating agencies have issued in the last few years, when certain abuses were put out, codes of conduct about quality, integrity, transparency, they were based on the model code of conduct developed by the IOSCO under the leadership of the SEC—particularly Commissioner Campos was very involved in this. And rating agencies are beginning to issue reports on how they have implemented their codes of conduct. Moody's and S&P have already done so. They are making good-faith efforts to improve the transparency of their ratings.

And I also understand that the SEC and the current NRSRO's have been working on a voluntary framework for SEC oversight of them. What role do you envision for the Commission in finalizing the framework, and what is the timeline here?

Chairman COX. Well, as you point out, the SEC has been supportive of the development of the IOSCO guidance. I think the recognition of the global aspect of this is very important. Albeit, it is essentially the U.S. firms that are dominant; this is a global business.

Also, with respect to the voluntary framework that is being developed by the NRSRO's themselves, that effort has been under way since somewhere in the middle of 2004, I think. We are working at the Commission on the assumption that we really do not know the answer to the question whether you are going to legislate or not on this topic, and therefore we need to be prepared alternatively with our own action or with cooperative technical guidance——

Senator SCHUMER. But do you intend to wait to see if we legislate before you do what you were doing?

Chairman COX. I will say, I am trying to be sensitive to the ongoing process. I mean, there have been hearings on both sides of the Capitol on this subject, and we want to be as supportive as we can on the technical side in the development of any legislation that might happen.

But no, we are not—since I do not know whether there will be any legislation, we are not going to abey until we know the answer to that question. We are proceeding apace.

Senator SCHUMER. You are?

Chairman COX. Yes.

Senator SCHUMER. Because you might come up with something that makes everybody happy and we will not have to legislate.

Chairman COX. That would be pleasant all around.

Senator SCHUMER. Yes, it would.

Okay, thank you, Chairman Cox.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Chairman, thank you very much for your appearance. It has taken us awhile this morning. We look forward to working with you. And Senator Sarbanes asked you earlier, alluded to the fact you have the resources you need. We will talk about that, because I chair a different committee and would like to sit down with you and see how you are doing with your money, what you need, and where you want to go. Fair enough?

Chairman COX. I welcome the opportunity, Mr. Chairman.

Chairman SHELBY. We will do that. Thank you.

The hearing is adjourned.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR JIM BUNNING

Welcome Chairman Cox. It is good to see you, and I am glad to see you have recovered from your surgery.

Chairman Cox, I am happy to read in your testimony that you are focusing your efforts on the individual investor. Making plain English the official language of the SEC is an important step to level the playing field for all investors. I wish that more of Washington would follow your lead.

Anything that can be done to improve access to information, and people's understanding of it, will help both new and experienced investors.

Your program to use modern electronic communications to reduce the burden on companies and the SEC will lead to more efficient regulation and management. But most importantly it will give investors more and easier access to financial data, and that will help them make better investment decisions and hopefully encourage more Americans to get into the markets. I am glad you are taking your time with the new data program to make sure it is done right. I think it is also important to make sure investors continue to have access to the information in ways they can use.

I hope the Commission does not rush to adopt proposals that could have the effect of making information, such as printed annual reports or proxy statements, harder for shareholders to get. The last Commission Chairman left you with some controversial and misguided proposals.

In fact, just weeks ago, the DC Circuit sent the regulation requiring independent chairman and directors for mutual funds back to the SEC for the second time. A court decision is coming soon on hedge fund regulation too.

Also, as many Members of this Committee stated in a letter to Chairman Donaldson, the proposed Regulation B goes against the clear intent of Congress in the Gramm-Leach-Bliley Act.

I encourage you to take a fresh look at those regulations and whether they are needed before proceeding with them.

I encourage you to keep looking out for all investors, and to do so in a way that encourages business innovation. Giving people access to better and more useful information is an important step, but financial education is also very much needed.

I look forward to hearing other ideas you have to help the public better understand the securities markets.

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Thank you, Chairman Shelby and welcome, Chairman Cox.

I have been following your efforts over the last 8 months and I want to commend you on a successful beginning. You have worked to gain consensus with your colleagues and establish some key reforms that have been beneficial to investors and consumers alike. I support your efforts in enhancing disclosures and simplifying the law.

As you know, the SEC's role is absolutely vital to maintaining a robust and vibrant economy, and providing working men and women the piece of mind they need to become investors in the American Dream.

As you testify today, I am very interested in hearing your suggestions to improve education for the common investor. As more and more individuals retire, I am concerned that the average investor will not have the resources to appropriately scrutinize the options available to them upon retirement.

In Michigan, this is a critical concern for families—workers who have worked hard and paid into a retirement account need to understand what their options are after retirement.

Second, I am interested in your perception of the global economy. I understand that the largest IPO's this year have been from foreign companies. In fact, the top three IPO's were from Chinese and French companies, and the largest IPO, China Construction Bank, was the biggest deal in 5 years.

In your opinion, what impact does this have on our domestic markets? And, how do you see this trend moving in the future?

Last, I have been hearing from businesses in Michigan that some of the current regulations out there are burdensome and costly. I hope to hear your opinions and improvement ideas to increase security yet maintain a manageable process for businesses.

Again, I want to commend you on a great beginning and I look forward to this ongoing dialogue on maintaining investor confidence and finding improvement opportunities whenever possible.

Thank you again for sharing your time with us today.

PREPARED STATEMENT OF CHRISTOPHER COX

CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION

APRIL 25, 2006

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for giving me the opportunity to be here today to testify about the initiatives and priorities underway at the Securities and Exchange Commission to improve financial disclosure for individual investors.

Several years ago, in the midst of rampant financial scandals and a crisis of investor confidence, this Committee held a series of exceptionally important hearings on corporate responsibility and investor protection. Those hearings, and the work of the Members of this Committee that followed, laid the foundation for landmark reforms that have restored investor confidence and the health of our capital markets. I commend each of you for your efforts, and am happy to report that the SEC is using the new tools that you have given us to ensure that those reforms are implemented exactly as intended by the Congress.

A lot has happened in the 9 months since I last sat at this table. I very much appreciate this opportunity to give you a report on the new initiatives the SEC has undertaken, as well as to hear from you about your priorities.

Introduction

The principal subject of this brief testimony is improving disclosure for the benefit of individual investors. If I may, I would like to take a step back and put these efforts into context.

As a Member of Congress for 17 years, I was constantly reminded by my constituents of the real world impact of the decisions we make here in the Capitol. Like every one of you, I learned the importance of being a good listener, and of remembering that the common sense of ordinary Americans is the essence and the strength of our democracy.

Most of your constituents are not investment bankers, or lawyers, or accountants. But most of them are investors. It is a stunning fact of life in the 21st century that a majority of Americans now own stocks, either directly or through mutual funds. It is chiefly to serve these people that the SEC exists. Our mission—to protect investors, promote capital formation, and maintain orderly markets—must always put ordinary Americans first.

Since making the transition from the halls of Congress to the SEC, I have set out to rededicate the agency's ongoing efforts in virtually every area to the service of the individual investor.

In a well-ordered market, educated consumers can choose from a number of competitive products, and find what they want at a price they are willing to pay. But in order to educate themselves, investors need comparative facts. So while investors must bear the responsibility of learning what they can about their investment choices, the correlative duty of sellers of investment products is to provide the relevant information. What's more, in order for investors to make sound decisions, the seller's information has to be understandable, accessible, and accurate.

These are the basic ingredients of healthy competition in every corner of the financial marketplace.

To more closely match the theory of a well-ordered market with today's reality, the SEC is currently pursuing four key initiatives to improve the quality and usefulness of disclosure for individual investors. These initiatives, taken together, are designed to ensure that investors have access to more accurate and understandable information about the securities they own or are considering buying.

These four initiatives are:

- Moving from boilerplate legalese to plain English in every document intended for retail consumption;
- Moving from long, hard-to-read disclosure documents to easy-to-navigate webpages that let investors click through to find what they want;
- Reducing the complexity of accounting rules and regulations; and
- Focusing our antifraud efforts on scams that target older Americans.

Making Disclosure Understandable for Ordinary Investors

It is the SEC's job to see to it that financial data and qualitative information about the issuers of securities are fully and fairly disclosed. But surely we cannot say we have achieved that objective if the information is provided in a way that is not clearly understandable to the men and women for whom it is intended. Empowering investors does not just mean better access to information—it also means access to better information. Simply put, the question is: Once that SEC-mandated in-

formation is available, is it understandable? The answer all too often is a resounding and frustrated "no."

Even though they are nominally written in English, the disclosure in some documents that are provided to investors is often so full of legal jargon and boilerplate disclosure that it can actually obscure important information.

Convoluted language and disclosure in footnotes may serve lawyers and insurance companies, but it does not improve an investor's ability to understand the most important facts about a particular investment.

Exhibit A when it comes to convoluted disclosure is today's regime for reporting executive compensation. Ordinary American investors have a right to know what company executives are paid, because those investors own the companies. The executives work for them.

It is a direct corollary of the fact that more than half of Americans own stock today, that executive compensation will be judged just like every other labor and material cost that a firm incurs. Gone are the days when investors were mostly privileged, high-income elites. Today's investors come from middle class households that sit around the kitchen table and make tough choices about their monthly budgets. They expect the companies they invest in to do the same.

But how can an investor judge whether he is getting the best executive talent at the best price? Too often, the most important parts of total compensation are hidden away in footnotes, scattered in different parts of the proxy statement, or—depending on the form the compensation takes—not even disclosed at all until after the fact.

Three months ago, the Commission voted unanimously to propose an overhaul of the executive compensation rules. This marks the first time in 14 years that the SEC has undertaken significant revisions of the disclosure rules in this area.

The proposal would require better disclosure on several fronts.

First, companies would report a "total" figure—one number—for all annual compensation, including perquisites.

Second, retirement benefits would be clearly outlined in new tables showing the defined-benefit and defined-contribution plans of top officers.

Third, there would also be clear descriptions of payments that could be made if an executive is terminated. No such disclosure is required under our current rules.

Fourth, for the first time, all compensation for the last year to board members would be fully disclosed.

Fifth, a new Compensation Discussion and Analysis section would replace the Compensation Committee Report and the performance graph, which is now often mere boilerplate and legalese. This new narrative section will allow the board members to have a frank discussion with their bosses, the shareholders, about how they have gone about determining the compensation for the company's top executives.

Just to be clear, the Commission does not propose getting into the business of determining what is the proper method or level of compensation. It is not the job of the SEC to substitute our judgment for that of the board. Nor would I, speaking as Chairman, subscribe to the notion that all executive pay is excessive. Surely many executives deserve every penny they are paid, and more. It should go without saying that being a CEO requires a rarefied collection of attributes and skills that are in all too short supply. And it is a fact that competition in the market for executive talent can be fierce. At the same time, I need not cite here the several notoriously public cases of extravagant wastes of shareholder assets by gluttonous CEO's and pliant compensation committees.

By improving the total mix of information available to investors, the directors who work for them, and the marketplace, we can help shareholders and compensation committees to better inform themselves and reach their own conclusions.

Sixth, and finally: Since the purpose here is to improve communications, the proposed rules require that all of this disclosure be in plain English—the new official language of the SEC. That will be true whether the information is in a proxy statement, an information statement, or an annual report.

Plain English uses plain words—and, among other basic ingredients, the active voice. We want to promote the use of the active voice not just because it makes for punchier sentences, but because it requires a definite subject to go with the predicate. That is the only way that investors will be able to figure out who did what to whom.

It is a testament to the importance of this issue that, when the comment period on these proposed executive compensation rules closed on April 10, we had received nearly 17,000 comments. That is one of the highest totals in the SEC's 72-year history. We are now reviewing these comments and look forward to incorporating them into any final rules that the Commission may adopt for improved, plain English compensation disclosure.

And we will not stop there. Some years ago, under Chairman Arthur Levitt, the SEC began a crusade for plain English in investor documents. It was a noble first step that has been carried on by both Harvey Pitt and Bill Donaldson. During my time at the Commission, I hope to advance this cause still further, so that ultimately every communication aimed at retail investors is so free of jargon and legalese that it could pass muster with the editors of the Money section of *USA Today*.

Improving Disclosure via Interactive Data

Making the SEC's mandated disclosures more useful to investors is the idea behind another of our initiatives: Interactive data.

The beauty of interactive data is that it will not only make today's 10K's, proxies, and mutual fund prospectuses more useful to investors, but it will also reduce much of the time and expense that companies currently devote to filing SEC reports.

Today, the SEC has over 800 different forms. Each form is required to have its own cover page. The genesis of this requirement dates back to when reports were hand-filed in steel cabinets. Back then, the cover pages helped Commission staff do the filing—but today, they provide no useful information to the public, or to the SEC. Despite the fact that every individual company is required to file many different forms, these cover pages ask over and over again for the very same information in a slightly different format. In other words, more junk disclosure that no one needs, or wants.

If one goes beyond the cover pages to the entire form, to focus only on the truly unique information in each one, it has been estimated that instead of the 800 forms now required, the SEC might have need of no more than a dozen.

The key to making this happen is looking at the data on the forms independently from the forms themselves. That is what we mean by interactive data. Computer codes can tag each separate piece of information on a report, and tell us what it is: Operating income, interest expense, and so forth. That way, every number in a report or financial statement is individually identified, both qualitatively and quantitatively.

For individual investors, this means they will be able to quickly search for any information they want without slogging through an 80-page document. And it means they could search through our database not by the names of individual reports, but instead just by looking up the companies that file them. We would no longer need what we have for domestic issuers today: 9 Securities Act registration statement forms, 3 Exchange Act registration statement forms, 2 annual report forms, 2 quarterly report forms, 1 current report form . . . and a partridge in a pear tree.

And I have not even gotten to all the forms for proxy materials, annual reports, securities ownership, tender offers, and mergers and acquisitions. Investors, and the analysts who interpret financial information for them, should not have to hunt around for each separate form—all the information should be in one place, organized by company. Today, every one of these forms has to be filed and processed separately, which adds to the SEC's workload; and then the investors have to separately hunt down every different form for a single company, making more work for all of them. Rube Goldberg would be proud.

Our initiative to let investors get information fast, easily, and all in one place, envisions this added benefit: Instead of long and hard-to-read annual reports and proxy statements, investors could have easy-to-navigate webpages that let them click through to find what they want.

I am extremely pleased that our interactive data initiative has the support of the Chairman and other Members of this Committee. In hearings and briefings before this and other Committees, you have heard the technology variously described as data tagging, or XBRL, or my personal favorite, interactive data. But whatever one calls it, the point is the same: To allow investors to more easily access, search, analyze, and compare data provided by public companies.

The move to interactive data represents a sorely needed upgrade in the SEC's electronic disclosure regime.

From the 1930's to the 1980's, the Commission required that disclosure documents be filed exclusively on paper. Thousands of companies mailed us hundreds of thousands of documents. Each document was date-stamped, copied, sent to various divisions for review, and made available to the public for physical inspection in a Washington, DC library that is still maintained by the agency at significant expense.

In the 1980's, the Commission pioneered the use of electronic filing on our EDGAR system. (EDGAR stands for Electronic Data Gathering, Analysis, and Retrieval.) This was a significant leap forward, and it became even more so with the dawn of the Internet. Now, investors and analysts are able to download documents

with the click of a mouse instead of making a trip to the SEC's library in Washington, DC.

But while EDGAR was a great improvement for the 1980's, 20 years is a lifetime in the computer age. EDGAR may be electronic, but it is not interactive. It does not begin to tap the potential of the Web. Because today's EDGAR filings are really just snapshots of paper reports that are stored in electronic form, the information they contain is not searchable. Nor can it be used in any of the myriad ways that electronic data now speed around offices, home computers, and the Internet.

With today's SEC reports, an investor or analyst who is looking to compare, say, data on annual capital expenditures of two companies, has to search through perhaps hundreds of pages of the filings of each company page-by-page. Not surprisingly, the burden of this time-consuming, tiresome task has led to the creation of a cottage industry in rekeyboarding the information in SEC reports, so that it can be downloaded into spreadsheets and other software. Investors, or more precisely the intermediaries whose fees they pay, can then buy this information from both domestic U.S. firms and overseas providers to whom the drudge work has been outsourced. Once the information is manually input, it is often first sold to third or fourth parties for further reduction and analysis before it eventually is made available to an individual investor.

One hates even to think of the human error and data corruption that inevitably occurs in this process. We know from experience that the error rate is unacceptably high.

Interactive data is a way to eliminate these problems, and to connect investors directly to the information in a company's filings—accurately, cheaply, and quickly. It will allow anyone to easily search, extract, compile, compare, and analyze financial and qualitative data according to each individual's preferences.

What about the benefits beyond retail investors? For preparers of financial reports, interactive data could streamline and accelerate the collection and reporting of financial information to the SEC and the public. Further down the road, the potential exists for companies to use interactive data as a means of getting real-time management control information.

The SEC is strongly committed to interactive data. This is why we have taken major steps to promote it. We have offered significant incentives for companies to file their financial reports using interactive data. These include expedited review of registration statements and annual reports. A number of well-known firms—the list is 17 and growing—have already begun to lead the way and are filing their reports using interactive data.

And because mutual funds and exchange-traded funds have become the investment of choice for millions of Americans, I am very encouraged that the Investment Company Institute and its member funds recently decided to throw their weight behind interactive data.

Throughout 2006, the Commission will host a series of roundtables focused on the move to interactive data. The first roundtable is in June. The discussions will focus on several topics:

- What investors and analysts really need from interactive data;
- How to encourage the development of software for companies, institutions, and retail investors that takes full advantage of the potential of interactive data; and
- How to redesign the SEC's disclosure requirements to maximize the advantage of using interactive data.

Our aim is to move from long, hard-to-read disclosure documents to easy-to-navigate webpages that let investors click through to find what they want. We want to emancipate the data from the page, and let it find its way across the Internet and around the world in the form of RSS feeds, AJAX applications, and whatever comes next. Revolutionizing the way the world exchanges financial information is a worthy goal. We intend to achieve it.

Accounting Complexity

When it comes to giving investors the protection they need, information is the single most powerful tool we have. It is what separates investing from roulette. But if the SEC is truly to succeed in helping investors with more useful information, we will need one more ingredient: An all-out war on complexity.

It is, of course, true that a complex world often requires complex solutions. And certainly, there are desirable states of complexity—the ones that arise from a thing's intrinsic nature: DNA. A snowflake. Encryption algorithms. There, the complexity is essential to the function. But it is the contrived, artificial complexities that cause the problems—intricacy without function. Winston Churchill said it best: "However beautiful the strategy, you should occasionally look at the results."

That, Mr. Chairman, is what we are now doing at the SEC. We are looking at results from the vantage point of the ordinary investor. And what we are finding is that, in many cases, we are not getting the right results. The complexity of the disclosure mandated by our rules too often adds nothing to function.

It is not just public companies that sometimes have difficulty using plain English. Our accounting rules and regulations also can sometimes be complex and difficult to interpret. And when the rules are difficult to interpret, they may not be followed very well. And if the rules are not followed very well, then intentionally or not, individual investors inevitably will suffer.

When complexity needlessly adds to the costs and efforts involved in financial reporting, it is the investors who foot the bill. And when a company takes advantage of detailed standards and complex reporting to hide information from investors, rather than to disclose it, investors are doubly damaged.

Not surprisingly, users of financial statements—investors and regulators alike—are looking for more balance in making financial reporting comparable and understandable. Preparers and auditors are also looking for standards that are easier to understand and implement.

The SEC has been helping to lead a major national effort to reduce complexity in financial reporting. The laboring oar is being manned by the Financial Accounting Standards Board, which is already intently focused on improving the understandability, consistency, and overall usability of the existing accounting literature. The SEC staff are working closely with the FASB in a supportive role.

The first step is to systematically readdress specific accounting standards that do not provide the most relevant and comparable financial information. Examples of standards in need of reworking for this reason include consolidations policy, certain off-balance sheet transactions, performance reporting, and revenue recognition.

The second task is to codify generally accepted accounting principles. The codification will be a comprehensive and integrated collection of all existing accounting literature, and it will be organized by subject matter. The aim is to provide a single, easily accessible source for all of GAAP. A dividend of this project is that it will provide a useful roadmap to those areas most in need of simplification.

A third priority is to stem the proliferation of new accounting pronouncements from multiple sources. We are encouraging the FASB to consolidate U.S. accounting standard setting under its auspices, and to develop new standards more consistent with a principles-based, objectives-oriented system.

The final element of this strategy is to strengthen the existing conceptual framework for U.S. GAAP in order to provide a more solid and consistent foundation for the development of objectives-oriented standards in the future.

Making financial reporting more user-friendly goes far beyond the work of the FASB. Weeding out the counter-productive complexity that has crept into our financial reporting will require the concerted effort of the SEC, the FASB, the PCAOB, and every market participant. This cannot be a one-time effort; we will have to commit for the long-term. But it will be well worth it.

Financial Education for Retirees and Elderly Investors

Finally, let me turn to our efforts to better protect older Americans against financial fraud.

Consider these statistics: An estimated 75 million Americans are due to turn 60 over the next 20 years. That's an average of more than 10,000 people retiring every day. Households led by people aged 40 or over already own 91 percent of America's net worth. The impending retirement of the baby boomers will mean that, very soon, the vast majority of our Nation's net worth will be in the hands of the newly retired.

Following the Willie Sutton principle, scam artists will swarm like locusts over this increasingly vulnerable group—because that is where the money is.

On a daily basis, our agency receives letters and phone calls from seniors and their caregivers who have been targeted by fraudsters. Sometimes there is still time to help. But often, the victims have already been taken. These fraudulent schemes may begin with a free lunch, but we want to make sure that they end with a very high cost to the perpetrators.

That is why we are attacking the problem from all angles—from investor education, to targeted examinations, to aggressive enforcement efforts. And because State securities regulators share our concern about fraud aimed at seniors, we are cooperating in this initiative with State regulators across the country—the local cops on the beat.

A top priority is education. SEC programs are aimed not only at older Americans and their caregivers, but also at preretirement workers, designed to help them reach their personal savings and investing goals as they age. While we cannot tell inves-

tors which products to purchase, we can arm them with the information they need to assess various products and investment strategies.

We are expanding our efforts to reach out to community organizations, and to enlist their help in educating older Americans about investment fraud and abuse.

A portion of the SEC website is devoted specifically to senior citizens *(http://www.sec.gov/investor/seniors.shtml).* We provide links to critical information on investments that are commonly marketed to seniors—including variable annuities, equity-indexed annuities, promissory notes, and certificates of deposit.

On the SEC website, investors can also find detailed warnings against the dangers of listening to the sales pitches of cold-callers. We are alerting seniors to the very real threat of affinity fraud—scams that prey upon members of groups to which they may belong, including their religion, their nationality or ethnic heritage, or their profession.

Seniors are often subjected to high pressure sales pitches that are simply not true, such as telling seniors that equity-indexed annuities "just can't lose money." There are also "free lunch" seminars that encourage seniors to buy complex products that do not fit the risk profile of a retiree with a relatively short life expectancy. There are also outright scams, such as Ponzi schemes.

To detect abusive sales tactics that target seniors, examiners in our SEC field offices will share regulatory intelligence with their counterparts at the State level, and with other regulators. Once we identify firms that may be preying on seniors, we will examine those firms to make sure their sales practices are lawful.

This effort has already started in Florida, where we've recently initiated on-site compliance examinations, along with the State of Florida and the NASD, of firms that sponsor "free lunch" investment seminars. Our goal is to see that the sales people at these seminars are properly supervised by their firms, and that the seminars are not used as a vehicle to sell unsuitable investment products to seniors.

Each of our offices across the country will work closely with State and local law enforcement, and both Federal and State regulatory agencies, to target scams aimed at seniors. And they will work together to bring both civil and criminal actions aimed at shutting them down. This effort is already well under way in California.

Finally, when we do find fraud, you can be sure that we will do something about it. Over the past 2 years, the SEC's Division of Enforcement has brought at least 26 enforcement actions aimed specifically at protecting elderly investors. Many of these actions were coordinated with State authorities.

In one notable case, *SEC* v. *D.W. Heath and Associates,* the Commission coordinated with the Riverside County District Attorney's Office to crack down on a $144.8 million Ponzi scheme that lured elderly victims in southern California to workshops with the promise of free food. The Commission's complaint alleged that the defendants then bilked them out of their retirement money by purporting to sell them safe, guaranteed notes.

Just last month, in *SEC* v. *Reinhard et al.,* the Commission halted another possible Ponzi scheme, this time in Allentown, Pennsylvania. The Commission's complaint alleges that the defendants raised more than $3.9 million from at least 50 investors in several States by claiming to sell certificates of deposit that did not exist.

The complaint further alleges that the primary salesman lured investors, many of whom are elderly, with promises of above-market rates on FDIC-insured CD's purportedly issued by a nonexistent entity called the "Liberty Certificate of Deposit Trust Fund." The complaint also alleges that the defendants distributed fictitious investment documents and account statements to attract investors and to ensure they continued to invest in the scheme.

As reflected in these recent cases, any would-be fraudsters should consider themselves on notice that the SEC's enforcement staff will aggressively investigate and file actions against anyone who preys upon seniors.

Conclusion

Mr. Chairman, Members of the Committee—thank you for your interest in these vital issues. Each of the four initiatives I have outlined is part of an overall strategy to make the individual investor—the average American—the ultimate beneficiary of all that we do at the SEC. Our agency has for many years proudly worn the badge of the "Investor's Advocate." In the months and years ahead, we are pledged to rededicate ourselves to that mission.

I appreciate the opportunity to be with you here today. Thank you for your continuing strong support for the work of the Commission. I am happy to answer any questions you may have.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM CHRISTOPHER COX

Q.1. Last November, the Commission committed to approving by June 30, 2006 self-regulatory organization rules to permit portfolio margining for securities futures and security options. I understand that NYSE and CBOE rule changes are pending that would do that by expanding the current pilot program that permits certain customers to use portfolio margining for certain limited classes of products. Do you anticipate that the Commission will be able to meet its commitment to Congress to act on these proposals by June 30?

A.1. I am pleased to report that on July 11, 2006 we approved rule changes at two major exchanges—the New York Stock Exchange and the Chicago Board Options Exchange to permit portfolio margining on equity options and security futures. In addition, we have also noticed for comment NYSE and CBOE proposals to permit single stocks and OTC derivatives to be included in a portfolio margin account. The public comment period for these two proposals closed in May. After reviewing comments received by the Commission, NYSE and CBOE recently submitted technical amendments to their proposals and I expect that the Commission will take action on the proposals in early September. In addition to these rules changes, I am also engaged in direct discussions with Ruben Jeffery, the Chairman of the Commodity Futures Trading Commission, to identify further areas of agreement on portfolio margining.

Q.2. The proposed NYSE and CBOE rules would allow broad-based futures to be included in a portfolio margining securities account I understand that there are some obstacles to actually including such futures in a securities account, because all of the financial instruments in a securities account must be provided with coverage by the Securities Investor Protection Act (SIPA), and SIPA specifically excludes futures from its coverage. In testimony before the Banking Committee last September, Bob Colby testified that the Commission supports targeted amendments to SIPA to address this issue. This sounds like an idea where a legislative fix is the cleanest way to make sure that the market can take full advantage of portfolio margining. Do you agree? If so, could the Commission provide us with some technical assistance in drafting a targeted amendment to SIPA?

A.2. The Commission agrees that targeted legislative changes to SIPA are the "cleanest" way to make sure customers can take full advantage of the new NYSE and CBOE portfolio margining rules. Under the NYSE's and CBOE's rules, securities and futures positions must be carried in a securities account to provide a customer with the protections of applicable securities laws and regulations. Including futures positions in a portfolio margin securities account, however, raises an issue as to how futures positions would be treated in a liquidation of a broker-dealer under SIPA.

SIPA protections apply to cash and securities held at a broker-dealer, but not to futures positions. This result is a function of the SIPA definition of "security," which specifically excludes futures. Moreover, there is no corresponding statutory protection for futures customers under which they would receive advances if futures as-

sets are missing. To assure SIPA protection to all products in a portfolio margin securities account, amendments to SIPA would enable customers to take full advantage of the portfolio margining rules. This legislative amendment could be very narrowly tailored to, in effect, provide that futures (including options on futures) held in a portfolio margin account under a Commission-approved portfolio margin program would receive SIPA protection, thereby extending SIPC protection to those futures products permitted to be deposited into a portfolio margin securities account. The Commission staff would be pleased to provide you with technical assistance in drafting such a targeted amendment to SIPA to address this issue.

At the same time, however, the Commission is actively engaged in a dialogue with the Commodity Futures Trading Commission and the futures and securities industry regarding the optimal means to structure cross margining between securities and futures positions—whether through a single account or separate securities and futures accounts (the so-called "one-pot" or "two-pot" models).

RESPONSE TO A WRITTEN QUESTION OF SENATOR ENZI FROM CHRISTOPHER COX

Q.1. Mr. Chairman, the position of the Chairman of the Public Company Accounting Oversight Board has been open since November 30, 2005. Since that time, Mr. Bill Gradison has served as Acting Chair, and has done an excellent job. Does the SEC have plans to nominate a new Chairman in the near future?

A.1. On June 19, 2006, the Securities and Exchange Commission was pleased to announce the appointment of Federal Reserve Board Governor Mark W. Olson to the position of Chairman of the five-member Public Company Accounting Oversight Board (PCAOB) until 2010. Mark Olson's experience as a central banker, his background in securities law, his expertise gained as partner in a major accounting firm, his management and business experience as a bank president, and his national leadership as President of the American Bankers' Association—together with his demonstrated commitment to public service and protecting the interests of investors—will be an exceptional addition to the PCAOB.

Mr. Olsen's appointment was conducted in accordance with the comprehensive selection procedures for the selection of Chairpersons and Board members of the PCAOB that the Commission approved last December. These new procedures are intended to make the selection process transparent, encourage the thorough consideration of all qualified candidates, ensure a thorough vetting of candidates, and establish timetables for the expeditious appointment of individuals of the highest caliber for this critical body.

These selection procedures build upon the previous practice of the Commission, and include a timetable for the recommendation of candidates, background checks, Commission interviews, and final selection. The new procedures will apply whenever vacancies occur.

Under these procedures, the SEC Chairman will lead a search to identify qualified candidates and will solicit nominations and input from each of the SEC's current Commissioners, who may each submit up to three nominations.

The SEC Chairman will also consult with the Secretary of the Treasury and the Chairman of the Federal Reserve, as required by the Sarbanes-Oxley Act, and solicit recommendations from other executive branch, Congressional, investor, academic, and business community sources, and such others as the SEC Chairman deems appropriate.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SANTORUM FROM CHRISTOPHER COX

Q.1. You may know that I have sponsored, along with Senator Allen and Senator Dole, S. 1396, a bill that would update the definition of eligible portfolio company (EPC) under the Investment Company Act of 1940. The House unanimously passed an identical version twice (H.R. 3170 in the 108th Congress and H.R. 436 in the 109th Congress).

Does the SEC agree the use of the Federal Reserve Board definition of "marginable security" as a statutory standard for what Business Development Companies (BDC's) can invest in is outdated? If so, while the SEC has been given authority to establish additional categories of companies that qualify for treatment as an EPC, is not the only way to eliminate this outdated standard through legislation striking the provision, as is accomplished in the pending legislation? Does the SEC oppose the pending legislation? If the SEC believes an alternative approach should be considered, what is that alternative approach?

A.1. We agree that the use of the Federal Reserve Board's definition of "marginable security" as a means to define an eligible portfolio company is outdated. As you know, that definition was amended by the Federal Reserve Board so as to make most securities marginable. Consequently, many companies that previously met the definition of eligible portfolio company may have lost their status as such.

As you know, the Commission has rulemaking authority to establish alternative criteria to define eligible portfolio company. Pursuant to that authority, the Commission proposed a new rule to define eligible portfolio company under the Investment Company Act. In developing the proposed rule, the Commission was mindful of Congress's intent when it established BDC's in 1980 that they should invest a significant percentage of their assets in small, developing, and financially troubled companies, largely defined as eligible portfolio companies. Accordingly, the proposed rule was intended to realign the definition of eligible portfolio company with that intent. The Commission received 36 comment letters addressing the proposed definition. Most commenters were concerned that the rule would not include many of the small public companies that historically would have met the definition of eligible portfolio company before the margin rule amendments. Commenters also suggested various alternative approaches. It is anticipated that the Commission will take final action on this rule in the near future.

The Commission has not taken a position on the legislation. At the request of staff of the House Financial Services Committee and the Senate Banking Committee, Commission staff has provided technical assistance on the legislation. Commission staff expressed its view that the legislation was drafted very broadly. Among other

things, it noted that the legislation, if adopted, could actually result in BDC's investing more of their assets in larger, well-established companies. Consequently, there could be less BDC capital available for small companies. The staff also noted its concern that the legislation, by permitting BDC's to invest more of their assets in larger, well-established companies, would make BDC's more closely resemble registered closed-end investment companies. The staff also noted that the legislation would not, however, provide BDC shareholders with critical investor protections available to shareholders of those other investment companies.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR STABENOW FROM CHRISTOPHER COX

Q.1. As I mentioned in my opening statement—the largest IPO's this year have been from foreign companies. Although U.S. IPO's continue to lead in total capital raised and number of deals, foreign markets are emerging. Not only are foreign companies offering larger equity deals around the world, but also foreign companies are also holding our debt in greater amounts.

In your opinion, will this trend continue into the future? And, how will the emergence of foreign-owned debt impact domestic markets?

A.1. The opportunity for companies to access worldwide capital is a positive trend that reflects the health of the U.S. and the global equity market, and one that we expect to continue. IPO's in the U.S. capital markets are the largest segment of global IPO's, with $33 billion raised in 2005, and represent 20 percent of the global capital market activity.

While the number and size of IPO's in the United States has dipped slightly in recent years, many smaller companies continue to list on the NYSE and Nasdaq. In 2005, over 70 countries hosted IPO's of over $1 billion and the largest offerings were conducted overseas. That so many foreign companies chose to list their securities in foreign markets is a welcome indication that the quality and liquidity of those markets has increased and that accounting and corporate governance standards are improving worldwide. However, as globalization provides companies with a wider choice of markets in which to raise capital, we have seen a decrease in multiple listings as companies seek to reduce their costs.

The SEC has responded to foreign company concerns about compliance with Sarbanes-Oxley requirements and their inability to deregister with a number of initiatives intended to reduce their compliance burdens while maintaining our high standards of investor protection. Among these initiatives is a proposal to facilitate the ability of foreign issuers to terminate their SEC reporting obligations when there is relatively little interest in their securities among U.S. investors. Foreign issuers also benefit from extended Section 404 internal control deadlines and the SEC continued evaluation of these requirements. Finally, the SEC supports efforts to converge accounting standards, and I have stressed the SEC's commitment to creating a "roadmap" for eliminating a requirement to reconcile financial statements prepared using International Financial Reporting Standards to U.S. GAAP.

With regard to how foreign-owned debt may impact domestic markets, our capital markets are based on transparency of information as it relates to many areas of disclosure. While our rules require public companies, and significant investors in those companies, to provide full disclosure of material information related to the sale, purchase, and ownership of a company's securities, our rules do not dictate who those significant investors may or may not be. Any person or entity that owns more than 5 percent of a public company's voting securities must publicly disclose certain information, including information regarding that person's intent in purchasing the securities. Our rules also require a public company to disclose information about that level of ownership of its securities.

Other Federal and State agencies as well as U.S. exchanges may regulate significant investments in public companies and may have some policy role in whether the emergence of foreign companies and foreign-owned debt impacts our markets.

Q.2. Recently, I came across a report that was conducted in 2004 by the Center for Medicare and Medicaid Services. The report revealed that the government was paying 9.3 percent in hospital overage charges. In Michigan, that percentage was even higher, 13.6 percent. It was my understanding that Section 404 was intended to establish internal controls for healthcare benefits—however, it seems that the current accounting standards for employee benefits may have contributed to these overage charges. I am concerned that the standards are not being enforced or applied as intended.

Do you have any suggestions for improvements or do you intend to rectify this issue in some other way?

A.2. The accounting standards related to employee benefits are based on the premise that post retirement health care benefits are part of an employee's compensation for services rendered. Since payment is deferred until retirement, the benefits are a type of deferred compensation. Under fundamental accrual accounting, during the years that the employee renders the necessary service the company accrues and reports the cost of providing those benefits to the employee and to the employee's beneficiaries and covered dependents. To estimate this cost, the company must make several assumptions, including an assumed discount rate to determine the present value of the future cash outflows currently expected to be required to satisfy the post-retirement benefit obligations. The primary accounting standards body in the United States, the Financial Accounting Standards Board (FASB), currently has a two-phase project underway to improve the reporting of these and other related post-retirement benefits. The first phase involves recognition of the overfunded or underfunded status of defined post-retirement plans as an asset or liability on a company's balance sheet. The second phase will be a more comprehensive reassessment of pension and post-retirement accounting. These accounting rules may vary, however, for government-owned hospitals, which are not subject to the Commission's reporting requirements.

Section 404 of the Sarbanes-Oxley Act of 2002 requires certain public companies to report to shareholders on the effectiveness of their internal controls over financial reporting. This reporting re-

quirement should provide reasonable assurance to investors that a company's financial records appropriately reflect the costs of health care benefits as calculated under the existing accounting standards. The Commission currently is reviewing alternatives to make this reporting more efficient and effective. This reporting requirement, however, does not apply to privately held or government-owned hospitals and medical facilities.

As noted above, the Commission and FASB are reviewing how to improve both the accounting for health care benefits and reports on companies' internal controls over financial reporting. Although we are not aware of any direct link between these requirements and hospital overage charges, we will be alert to such issues as we proceed.